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European Bank
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Corporate Governance in Transition Economies

Georgia Country Report

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Prepared by:
Gian Piero Cigna
Yaryna Kobel
Alina Sigheartau

With the assistance of:
Nestor Advisors

Comments are welcome: please provide comments to cignag@ebrd.com

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The contents of this publication reflect the opinions of individual authors and do not necessarily reflect the views of the EBRD.

The report is based on information available at the end of April 2015.

If you believe that the information has changed or is incorrect, please contact Gian Piero Cigna at cignag@ebrd.com

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This Report – along with all other country reports prepared within this initiative – is available at: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html

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 ±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

The primary sources of corporate governance legislation in Georgia are the Law on Entrepreneurs; the Law on Activity of Commercial Banks; the Accounting and Auditing Law; and the Law on Securities Market. The National Bank of Georgia has also issued a number of Regulations relevant to corporate governance.

A Corporate Governance Code for Commercial Banks was developed in 2009 by the Association of Banks. The Code is meant to be applied under the so called "*comply or explain*" mechanism, according to which banks should either comply with the proposed recommendations or explain the reasons for non-compliance. However, there are no mandatory requirements to this end and the Code does not seem to be taken as a reference.

Structure and Functioning of the Board

Companies are organised under a two-tier board system. Supervisory boards (hereafter "boards") are generally small, with an average of 4.7 members for the ten largest companies. Evidence shows that smaller boards tend to perform better, provided they have the necessary mix of skills and support (e.g. corporate secretary), but this does not seem to be the case in Georgia. Legal entities cannot be board members. Board gender diversity is low.

There are qualification requirements only for banks' board members. Seven out of the ten largest companies disclose some information on their board members' qualifications. These boards do not seem to have a diversified mix of skills and only in two cases they include expertise in the field of audit, accounting, or risk.

There is no requirement for companies to have any independent directors on their boards. In banks, the law simply requires that supervisory board members "*must act reasonably and independently*". The Corporate Governance Code for Banks (the only Code that exists in the country) recommends banks to maintaining an adequate balance between representatives of shareholders and independent board members, but it appears that only very few banks have independent directors on boards. The Code also provides for a definition of independence, which is not comprehensive and includes only negative "*non-affiliation*" requirements. However, the Code recommends that "*independent supervisory board members should be particularly attentive to objectivity and impartiality regarding the rights of all shareholders and the supervision of executive management*".

The law does not require companies to establish any board committees. In banks, the audit committee is established by decision of the supervisory board, but it is not clear if banks are required to do so, as not all banks in our sample disclosed having an audit committee in place. The audit committee is to be composed of independent members, which are defined as not being "*connected to the bank and not have financial liability to the bank*"; this leaves room to non-board members to sit in the audit committee. The Code however recommends that the audit committee should be made only of non-executives and to include at least one independent member of the supervisory board.

The Law on Entrepreneurs foresees that the supervisory board is in charge of overseeing the management, and of the appointment and dismissal of executive directors. Further, the law provides that approval of the supervisory board is required for the annual budget and for "*general principles of economic policy*". This can be generally interpreted as strategic guidance, but there is no explicit reference to the approval of the company's strategy or setting risk profile/appetite as key board functions. For banks, the framework is clearer in assigning all key functions to the supervisory board.

There is no developed practice of board evaluation or of appointing company secretaries.

Liability of board members and conflict of interests are regulated, but the legal framework on directors' duties of care and loyalty does not appear to be well developed.

Transparency and Disclosure

Companies are required to include financial and non-financial information in their annual reports; however, corporate governance information provided by companies – albeit sometimes quite elaborated - is mainly just a "*copy and paste*" from the company's bylaws and does not relate to companies practices.

Six (five are banks) among the ten largest listed companies posted their annual reports with both financial and non-financial information online. In the other four cases, annual reports include financial information only.

Companies are required to disclose their financial statements, which should be compiled in line with IFRS, and all ten largest companies appear to comply with this requirement.

Only two companies out of the ten largest publish the minutes of the general shareholders' meeting on their websites.

Large companies are required to appoint external auditors and disclose their names and reports, and all ten largest companies appear to comply with this requirement. Provision of non-audited services by the external auditor is allowed. The Corporate Governance Code for Banks recommends that audit committees should develop policies and procedure related to the external auditor's rendering of non-audit services. No bank among the ten largest listed companies in the country disclosed having such a policy in place. It appears that companies disclose advisory and consulting and audit fees together, but it is not clear to whom these fees are paid as no other information on non-audit fees is disclosed.

Internal Control

Only banks are required to have an internal audit function in place. Despite the lack of legal requirement, the majority of the companies in our sample disclosed having internal audit units in place.

Banks are also required to have a separate compliance function. However, none of the banks disclosed having this function in place.

Only banks seem to be required to set up audit committees; however the law only vaguely regulates its composition. Four out of the ten largest companies (all banks) disclosed having audit committees in place. In one case the audit committee is made entirely of independent board members and in two other cases exclusively and by a majority of "*outsiders*" (i.e., non-board members). We have doubts about the effectiveness of the committee composed of "outsiders". The other companies do not disclose the composition of their audit committees. Activities and frequency of meetings of the audit committee are generally not disclosed.

There is no requirement to have a code of ethics in place and no company disclosed having one in place.

Large companies are required to appoint an independent external auditor, and all auditors declare to be independent, but it is not clear who should run the "*independence test*". The right to appoint the external auditor is reserved to the general shareholders' meeting. External auditors are allowed to provide non-auditing services and this might undermine their independence. Rotation of the external auditor is not required. Auditors sign the opinion only with the firm name, which is a legal nonsense.

The legal framework does not provide for any specific protections for whistle-blowers.

Related party transactions and conflicts of interests are regulated.

Rights of Shareholders

Minority shareholders are entitled to call a general shareholders meeting (GSM) and ask questions at the GSM. Furthermore, shareholders are endowed with pre-emptive rights in case of capital increase. Supermajority is required to approve major corporate changes. Shareholders are also entitled to bring a derivative claim, but it depends on the approval of shareholders. It is not clear if shareholders can propose new items to the GSM agenda or if they have inspection rights.

Insider trading and self-dealing are regulated by law, but there is little evidence of implementation and enforcement.

Supermajority is required to approve major corporate decisions. Cumulative voting is foreseen to appoint members of the supervisory board and it seems to be used in practice.

Share registers of companies with more than 50 shareholders and listed companies should be maintained by an external independent registrar. Significant shareholding variations must be disclosed. Shareholders agreements do not need to be disclosed. It is not clear whether they are enforceable, since they seem to be very rare in practice.

Stakeholders and Institutions

The institutional framework supporting good corporate governance needs improvement. The Georgian Stock Exchange has very low liquidity and does not seem to be in a position to promote good corporate governance standards. However, both the stock exchange and the regulator maintain a webpage with regulatory submissions by listed companies.

There is a very limited presence of international law firms and credit rating agencies, which usually provide some contribution to enhancing corporate governance. There is no corporate governance code for companies.

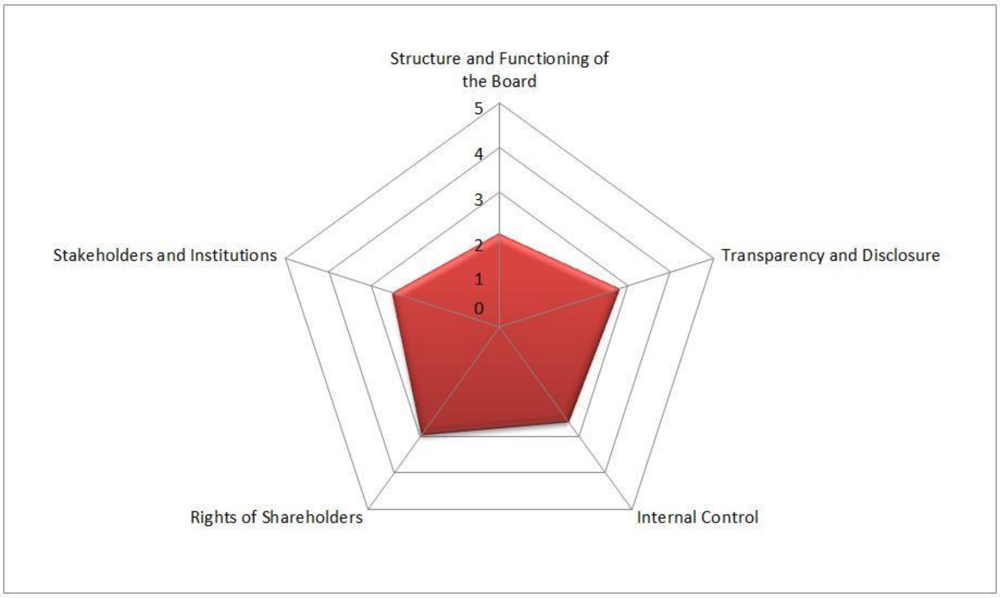
The Corporate Governance Code for Banks was adopted in 2009, with no subsequent revisions. It operates on a "*comply or explain*" basis. There are however, no mandatory requirements to this end and in practice the Code seems to be disregarded.

Judicial practice on corporate governance issues seems to be limited.

The National Bank of Georgia is the supervisory authority and the regulator for the whole financial market in the country; it has the authority to address corporate governance failures and compel appropriate remedial action.

International organisations' indicators place the country very well in terms of strength of investor protection, and relatively well on corruption perception and competiveness.

Corporate Governance Legislation and Practices in Georgia



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.

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

Key Areas and Rating	***Strengths and Weaknesses***
1. Structure and Functioning of the Board *Weak*	*Companies are organised under a two-tier board system. Supervisory boards (hereafter "boards") are generally small, with an average of 4.7 members for the ten largest companies. Evidence shows that smaller boards tend to perform better, provided they have the necessary mix of skills and support (e.g. corporate secretary), but this does not seem to be the case in Georgia. Legal entities cannot be board members. Board gender diversity is low.* *There are qualification requirements only for banks' board members. Seven out of the ten largest companies disclose some information on their board members' qualifications. These boards do not seem to have a diversified mix of skills and only in two cases they include expertise in the field of audit, accounting, or risk.* *There is no requirement for companies to have any independent directors on their boards. In banks, the law simply requires that supervisory board members "must act reasonably and independently". The Corporate Governance Code for Banks (the only Code that exists in the country) recommends banks to maintaining an adequate balance between representatives of shareholders and independent board members, but it appears that only very few banks have independent directors on boards. The Code also provides for a definition of independence, which is not comprehensive and includes only negative "non-affiliation" requirements. However, the Code recommends that "independent supervisory board members should be particularly attentive to objectivity and impartiality regarding the rights of all shareholders and the supervision of executive management".* *The law does not require companies to establish any board committees. In banks, the audit committee is established by decision of the supervisory board, but it is not clear if banks are required to do so, as not all banks in our sample disclosed having an audit committee in place. The audit committee is to be composed of independent members, which are defined as not being "connected to the bank and not have financial liability to the bank"; this leaves room to non-board members to sit in the audit committee. The Code however recommends that the audit committee should be made only of non-executives and to include at least one independent member of the supervisory board.* *The Law on Entrepreneurs foresees that the supervisory board is in charge of overseeing the management, and of the appointment and dismissal of executive directors. Further, the law provides that approval of the supervisory board is required for the annual budget and for "general principles of economic policy". This can be generally interpreted as strategic guidance, but there is no explicit reference to the approval of the company's strategy or setting risk profile/appetite as key board functions. For banks, the framework is clearer in assigning all key functions to the supervisory board.* *There is no developed practice of board evaluation or of appointing company secretaries.* *Liability of board members and conflict of interests are regulated, but the legal framework on directors' duties of care and loyalty does not appear to be well developed.*
1.1. Board Composition *Weak/Fair*	***Strengths:*** • *Joint-stock companies are organised under a two-tier system, where the general shareholders' meeting appoints the members of the supervisory board, which in turn has the exclusive authority to appoint and remove executive directors.* • *Legal entities cannot serve as board members.* • *Board members of banks are required to fulfil qualification requirements. The Regulation on Fit and Proper Criteria for Administrators of Commercial Banks requires board members in banks to have "university education in economics, finance, banking, business administration, audit, accounting or law" while "the appropriate qualification and professional experience and the composition of the supervisory board should ensure a variety of experience and skill set, which corresponds to the scale and complexity of the bank's activities".* ***Weaknesses:*** • *According to the Law on Entrepreneurs, supervisory boards of joint stock companies shall consist of at least 3 and up to 21 members. The supervisory boards of the ten largest listed companies have between 2 and 7 members (average 4.7). Evidence has shown that smaller boards tend to perform better; however, an average of 4.7 members seems to be too low to accommodate the mix of skills required for boards to duly perform its role (in one case, it appears that the board is made of 2 members). Further,*

Key Areas and Rating	Strengths and Weaknesses
	the limit of 21 members provided by law seems excessive. • *There are no qualification requirements or recommendations for board members in companies (the law only requires that they should be "experienced person in the economic activity". Seven out of the ten largest companies disclose some information on their board members' qualifications. These companies do not seem to have a diversified mix of skills at the board, and only two of them disclosed to have at least one board member with expertise in audit, accounting, or risk.* • *The law does not require companies to establish any board committees. Only banks seem to be required to set up audit committees, but there is no clear requirement that audit committee should be made only of independent board members. In practice, not even all banks among the ten largest companies disclosed having the audit committee in place. Only two companies – both banks – disclosed the composition of the audit committee: in one case the audit committee is made entirely of independent board members, in the other case it is made entirely of non-board members.*
1.2. Gender Diversity at the Board (14.67%) *Weak*	• *All ten largest listed companies disclose the names of their directors; four companies count one woman and one company counts two women. In these boards, woman representation averages 29.33%* • *In total, there are 6 women out of 47 board members.* • *When counting all the ten companies in our sample, the average of women directors per board falls to 14.67%.*
1.3. Independent Directors *Very Weak*	***Strengths:*** • *In banks, the law requires that supervisory board members "must act reasonably and independently".* ***Weaknesses:*** • *There are no requirements for independent board members in companies, while in banks the requirement is only vaguely expressed.* • *The Law on Activities of Commercial Banks provides a very basic definition of independence, according to which board members shall be deemed independent if they are not connected to the bank and they and/or their relatives have no financial liability to the bank.* • *The Corporate Governance Code for Banks defines independence only in negative "non-affiliation" terms. It does not foresee any "positive criteria" of independence; however, it recommends that "independent supervisory board members should be particularly attentive to objectivity and impartiality regarding the rights of all shareholders and the supervision of executive management".* • *The Corporate Governance Code for Banks recommends that audit committees should be composed exclusively of non-executive directors and to include at least one independent member of the supervisory board. However – from the disclosure provided by largest companies and banks – it appears that the Code is not taken as a reference.* • *Only one company (a bank) among the ten largest companies disclosed having independent board members (i.e., 5 out of 7 members), but it is unclear which criteria were used to classify these members as independent.*
1.4. Board Effectiveness *Weak*	***Strengths:*** • *The law requires that the supervisory board should meet at least quarterly.* • *In banks, the audit committee is established by the supervisory board and reports to it. The Corporate Governance Code for Banks further recommends that, at a minimum, the supervisory board should set audit and risk management committees. It also recommends banks to establish remuneration committees. However, committees are rare in Georgia.* ***Weaknesses:*** • *Only one company (a bank) disclosed the number of the board meetings in the previous year. It appears that the board had 4 scheduled meetings and 41 "special meetings", without giving further explanation on the matters and whether those meetings were held in person or in absentia. Further, 41 meetings seem excessive for a supervisory board, and could serve as indication that boards might be dealing with a number of operational issues, which is not a good practice. The same company disclosed the number of audit committee meetings, being 4 in the previous year.* • *No company disclosed the activities of its board in their annual reports. In some cases, the annual reports refer to the activities of the board, but it is just a "copy and paste" from the company's bylaws, without any reference to the activities undertaken in practice. Hence, it was not possible to assess the effectiveness of boards.* • *Except for banks, the law does not require companies to establish any board committees.* • *Only four out of the ten largest companies (all banks) disclosed having an audit committee in place. In two banks, the audit committee is made respectively by a majority and entirely by non-board members. We have doubts about the effectiveness of a committee composed of "outsiders" (see below).* • *Only one company in our sample disclosed having a nomination committee and two a remuneration committee. The composition of these committees is disclosed (they are all made of board members), but not their activities and number of meetings of the committees is again not disclosed; hence it is not possible to understand if they are playing a key role in the company.* • *The Corporate Governance Code for Banks recommends having a corporate secretary; only one of the companies in our sample disclosed having appointed one.* • *Despite the fact that the Corporate Governance Code for Banks recommends the board to "evaluate board members individually, or assess the board as a whole", no bank in our sample disclosed undertaking this exercise.*

Key Areas and Rating	Strengths and Weaknesses
1.5. Responsibilities of the Board *Fair/Weak*	***Strengths:*** • *The Law on Entrepreneurs foresees that the supervisory board is in charge of overseeing the management, and of the appointment and dismissal of executive directors. Further, the law provides that approval of the supervisory board is required for the annual budget and for "general principles of economic policy". This can be generally interpreted as strategic guidance, but there is no explicit reference to the approval of the company's strategy or setting risk profile/appetite as key board functions. For banks, the framework is clear in assigning these functions to the supervisory board.* • *Board members who have any conflicts of interest should abstain from voting with respect to such decision. Banks are subject to a specific regulation on conflict of interest.* ***Weaknesses:*** • *The law states that directors and members of the supervisory boards are responsible for the probity of financial statements; however joint and several liability is established only for management. The chairman of the supervisory board and the company designee who signs the financial statements are individually liable. This is not in line with international good practice (including in the EU) where members of the board are collectively responsible for the probity of financial statements.* • *The legal framework on directors' duties of care and loyalty does not appear to be well developed. Further, the Corporate Governance Code refers to board members as "representatives of the shareholder". This wording is used to distinguish independent directors from the others, but we believe that such expressions should not be used, as directors should only represent the company and all shareholders and never be the representative of shareholders.* • *As noted above, in companies the law is not clear in assigning the board with all its key functions.*

Key Areas and Rating	Strengths and Weaknesses
2. Transparency and Disclosure *Fair*	*Companies are required to include financial and non-financial information in their annual reports; however, corporate governance information provided by companies – albeit sometimes quite elaborated - is mainly just a "copy and paste" from the company's bylaws and does not relate to companies practices.* *Six (five are banks) among the ten largest listed companies posted their annual reports with both financial and non-financial information online. In the other four cases, annual reports include financial information only.* *Companies are required to disclose their financial statements, which should be compiled in line with IFRS, and all ten largest companies appear to comply with this requirement.* *Only two companies out of the ten largest publish the minutes of the general shareholders' meeting on their websites.* *Large companies are required to appoint external auditors and disclose their names and reports, and all ten largest companies appear to comply with this requirement. Provision of non-audited services by the external auditor is allowed. The Corporate Governance Code for Banks recommends that audit committees should develop policies and procedure related to the external auditor's rendering of non-audit services. No bank among the ten largest listed companies in the country disclosed having such a policy in place. It appears that companies disclose advisory and consulting and audit fees together, but it is not clear to whom these fees are paid as no other information on non-audit fees is disclosed.*
2.1. Non-Financial Information Disclosure *Fair*	***Strengths:*** • *According to the Securities Law, listed companies and companies licensed by the National Bank of Georgia are required by law to prepare annual reports to be submitted to the regulator, published or distributed to shareholders. By law, annual reports should include information on the activity of the companies, members of their bodies, beneficial holders of 5 per cent or more of the company's shares, audited financial statements, and other information required by the National Bank of Georgia. The Corporate Governance Code for Banks recommends annual reports to include a comprehensive section on information disclosure and transparency.* • *Six (five are banks) among the ten largest listed companies posted their annual reports with financial and non-financial information online. In one case, the most recent annual report is two years old. The annual reports of the other four companies include only financial information.* • *It appears that at least six of the ten largest companies posted their articles of association on their websites, even though there is no requirement to this effect.* • *All ten largest companies disclose the names of their directors. Seven of them disclose some information on their board members' qualifications.* • *Eight companies provide up-to-date information on their shares and capital on their websites or on the stock exchange website and nine out of the ten largest companies provide up to date information on their major shareholders. In six out of the ten largest companies' websites, the most recent announcement is less than 2 months old.* ***Weaknesses:*** • *Information provided by companies on corporate governance issues is often just a "copy and paste" from the company's bylaws and does not relate to companies practices.* • *It appears that information provided on the websites on the ten largest listed companies is often incomplete.* • *By the letter of the Corporate Governance Code, banks should apply the Code under a "comply or explain" basis, according to which banks should either comply with the proposed recommendations or explain the reasons for non-compliance. However, there are no mandatory requirements to this end, and in practice the Code does not seem to be implemented at all. None of the banks in our sample provide any "comply or explain" statement.* • *No company discloses the activities of the board in their annual reports. Only one company (a bank) disclosed that its board had 4 scheduled meetings in the previous year and 41 "special meetings", without providing further information. The same company – the only one among the ten largest listed companies - disclosed the number of audit committee meetings, being 4 in the previous year.* • *Only two among the ten largest companies disclose the minutes of their general shareholders' meeting on their websites.* • *There is no requirement to have or disclose a code of ethics and none of the largest companies provides this information.*

Key Areas and Rating	Strengths and Weaknesses
2.2. Financial Information Disclosure *Fair*	***Strengths:*** • *Listed companies and banks are required since 1999 to prepare and disclose their financial statements in line with IFRS. All ten largest listed companies appear to comply with this requirement.* ***Weaknesses****:* • *Despite the high level of disclosures, a recent World Bank Report on the Observance of Standards and Codes (2015) has pointed out that actual compliance with IFRS and ISA in the country is relatively low. The same Report points out that "Public access to financial statements in Georgia remains limited. Financial statements of commercial banks are publicly disclosed and can be accessed through their internet pages. By contrast, access to the financial statements of other regulated entities is difficult, even though they are required to publicly disclose these. Companies other than joint stock companies reporting to the National Bank's non-banking supervision department, are not required to file or publish their financial statements regardless of their size and legal incorporation". Further "Most entities had consistent non-compliance with IFRS in some key areas, even if the non-compliance presented itself in different ways. Recurring areas of non-compliance included significant accounting policy; related party disclosures; property, plant and equipment; impairment; fair value; and financial instruments risk disclosures".*
2.3. Reporting to the Market and to Shareholders *Weak*	***Strengths:*** • *All ten largest companies disclosed their audited financial statements.* • *The law requires companies to disclose price sensitive information.* ***Weaknesses****:* • *Only six among the ten largest companies posted their annual reports with both financial and non-financial information online. In one case, the most recent annual report is two years old.* • *The Law on Securities Market provides for liability in case the reporting/publishing rules are violated. It appears that only one company was fined for an amount of GEL 1,000 (approximately EUR 450) for breach of the reporting rules. Fines seem to be too low to deter breaches.* • *There is no legal requirement for companies to disclose the minutes of the general shareholders' meeting on their websites. In practice, only two among the ten largest companies do so.* • *The above mentioned World Bank Report points out that "Financial statements of regulated entities are publicly available to varying degrees. Banks, insurance companies and joint stock companies reporting to the National Bank's non-banking supervision department, are required to file their audited financial statements with their respective regulators. However, requirements to publish financial statements vary. Stakeholders have the most access to bank's financial statements but there is no general requirement for non-regulated entities to file or publish their financial statements, and as a result the public does not have easy access to financial statements in Georgia. This lack of readily available financial information hinders decision-making, lowers the quality of underwriting and impacts the risk management process of other stakeholders, such as investors or creditor".*
2.4. Disclosure on the External Audit *Fair*	***Strengths:*** • *The law requires an external auditor to be appointed for: (1) listed companies; (2) entities licensed by the National Bank of Georgia (i.e., commercial banks); and (3) entities with over 100 shareholders. The external auditor has to be independent. The external auditors of all ten largest companies declared to be independent.* • *It appears that large companies are required by law to make publicly available the name and opinion of their external auditor.* ***Weaknesses:*** • *Provision of non-audited services by external auditors is allowed. The Corporate Governance Code for Banks recommends that audit committees should develop policies and procedure related to the external auditor's rendering of non-audit services. No bank among the ten largest listed companies in the country disclosed having such a policy in place. It appears that companies disclose advisory or consulting and audit fees together, but it is not clear to whom these fees are paid as no other information on non-audit fees is disclosed.* • *It appears that there is no rotation requirement for external auditors. Further, it is not possible to assess the rotation of audit partners, since independent auditor's reports are signed only with the firm's name without any mention of the responsible partner. This is a legal nonsense as no one should be allowed to sign an official document only with the name of the legal entity.*

Key Areas and Rating	***Strengths and Weaknesses***
3. Internal Control *Weak*	*Only banks are required to have an internal audit function in place. Despite the lack of legal requirement, the majority of the companies in our sample disclosed having internal audit units in place.* *Banks are also required to have a separate compliance function. However, none of the banks disclosed having this function in place.* *Only banks seem to be required to set up audit committees; however the law only vaguely regulates its composition. Four out of the ten largest companies (all banks) disclosed having audit committees in place. In one case the audit committee is made entirely of independent board members and in two other cases exclusively and by a majority of "outsiders" (i.e., non-board members). We have doubts about the effectiveness of the committee composed of "outsiders". The other companies do not disclose the composition of their audit committees. Activities and frequency of meetings of the audit committee are generally not disclosed.* *There is no requirement to have a code of ethics in place and no company disclosed having one in place.* *Large companies are required to appoint an independent external auditor, and all auditors declare to be independent, but it is not clear who should run the "independence test". The right to appoint the external auditor is reserved to the general shareholders' meeting. External auditors are allowed to provide non-auditing services and this might undermine their independence. Rotation of the external auditor is not required. Auditors sign the opinion only with the firm name, which is a legal nonsense.* *The legal framework does not provide for any specific protections for whistle-blowers.* *Related party transactions and conflicts of interests are regulated.*
3.1. Quality of the Internal Control Framework *Weak/Fair*	***Strengths:*** • *Even though only banks are explicitly required to set up an independent internal audit function, seven among the ten largest companies (including five banks) disclosed having internal audit units in place.* • *The National Bank of Georgia has issued a Regulation on Internal Audit Requirements for Commercial Banks.* • *Banks seem to be required to create an audit committee, upon decision of the supervisory board and reporting to it. By law, the audit committee should only include "independent members". The functions of the audit committee with respect to the internal audit are detailed in the above mentioned National Bank's Regulation.* • *There is an Institute of Internal Auditors in the country.* ***Weaknesses:*** • *Even though banks are required to establish a compliance function, in practice, none of the banks disclosed having this function in place.* • *The law does not require companies to establish the audit committee.* • *In banks, the law does not clarify if the "independent members" of the audit committee should be board members or not. The law simply states that audit committee members should not be connected to the bank and neither they nor their relatives should have financial liability to the commercial bank. In practice, not even all banks in our sample disclose having an audit committee. Further, their composition varies. In one case, the audit committee is made exclusively of independent board members; in another case it is entirely composed of "outsiders". This latter solution raises some doubts.* • *There is no requirement in the law to adopt a code of ethics and no company discloses having such a code in place.* • *The legal framework does not provide for any specific protections for whistle-blowers.*
3.2. Quality of Internal and External Audit *Fair*	***Strengths:*** • *The Law on Activity of Commercial Banks and the National Bank's Internal Audit Requirements for Commercial Banks require banks to set up an independent internal audit function. Seven among the ten largest companies (five are banks) disclosed having internal audit units in place.* • *The function, responsibilities and independence requirement for the internal auditors are detailed in the above mentioned National Bank's Regulation.* • *In banks, the internal auditor reports quarterly to the audit committee. The appointment, removal and remuneration of the internal auditor are subject to the audit committee's approval.* • *The appointment of external auditor is required for: (1) listed companies; (2) entities licensed by the National Bank of Georgia (i.e., commercial banks); and (3) entities with over 100 shareholders.* • *The right to appoint external auditors is reserved to the general shareholders' meeting.* • *Nine companies among the ten largest in the country are audited by international audit firms; one company is audited by a local auditor. Incidentally, seven of them are audited by the same audit firm.* • *The banking regulations require the external auditors to "refuse to render any service that may endanger auditor's independence / impartiality in accordance with the IFAC Code of Ethics".* • *A new Accounting and Auditing Law was approved in 2012. The Law requires that audits must be*

Key Areas and Rating	Strengths and Weaknesses
	conducted in compliance with ISA. ***Weaknesses:*** • *The law requires external auditors to be independent and the auditors of all ten largest companies declared to be independent. However, it is not clear who should run the "independence test" (assess auditors' independence). The Corporate Governance Code for banks is also silent on this issue.* • *Provision of non-audit services (while simultaneously providing audit) by external auditors is allowed. The Corporate Governance Code recommends that audit committee should develop policies and procedure related to the external auditor's rendering of non-audit services. No bank among the ten largest listed in the country disclosed having such a policy in place.* • *The rotation of the external auditor is not foreseen by law or by the Corporate Governance Code for banks. It seems that one among the ten largest companies did not rotate its auditor for the last 7 years and another company for the last 11 years. Further, it is not possible to assess the rotation of audit partners, since independent auditor's reports are signed only with the firm's name without any mention of the responsible partner.* • *Even if the regulation on the internal audit in banks is generally sound, its effectiveness relies on the independence and effectiveness of the audit committee, which is only vaguely regulated and in practice does not seem to provide any assurance of independence.* • *The above mentioned World Bank Report points out that "Auditor liability is not clearly regulated. The 2012 Accounting and Auditing Law could be more specific. In practice, there are examples of attempts to contractually limit auditor liability to the fees received for the statutory audit (or a multiple). It is unclear whether such practice would be upheld in a Georgian court as there appear to be no cases of legal disputes between auditor and audited company".*
3.3. Functioning and Independence of the Audit Committee *Weak*	***Strengths:*** • *Banks - and only banks – seem to be required to establish audit committees. The audit committee is appointed by the supervisory board and reports to it. The Corporate Governance Code for Banks recommends that audit committee members should have sufficient appropriate knowledge and experience in financial sector. The Code also recommends that only non-executive members should be the members of audit committee and that at least one member of the committee should be an independent board member.* • *A National Bank's Regulation details the functions and responsibilities of the audit committee with respect to internal audit.* ***Weaknesses:*** • *Only four banks – among the ten largest companies – disclosed having established audit committees. Other two banks (among the companies in our sample) are silent on whether they have an audit committee in place. Only two provide details on their composition. In all cases, the independence and qualification of members of the audit committee cannot be evaluated as disclosure on this matter is very limited.* • *The requirements on the composition and independence of the audit committee are only vaguely drafted. This causes banks to freely decide on the composition of the audit committee and in at least two cases it appears that the audit committee is composed by a majority and exclusively of "outsiders" (i.e., non-board members). We have strong reservations about this solution. We believe it is important that the audit committee include only supervisory board members if the functions delegated to the committee are typical supervisory board functions. Secondly, We believe that it is essential that members sitting in the audit committee and recommending specific actions to the board follow up on such recommendations, reinforcing their positions and the board's 'objective judgement'. Further, 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.* • *Only one company disclosed the number of audit committee's meetings per year. No company discloses information on its audit committee's activities.*
3.4. Control over Related Party Transactions and Conflict of Interest *Fair*	***Strengths:*** • *Georgia recently amended its Securities Law to enhance approval and disclosure requirements for related-party transactions. Related party transactions are to be approved by the supervisory board or the general shareholders meeting, and must to be disclosed in the financial statements.* • *The Corporate Governance Code for Banks recommends that supervisory board members should abstain from decision-making on issues involving conflicts of interest or related party transactions.* • *Conflicts of interest are regulated by law. According to the Law on Securities Market, in case of conflicts between the interests of the board members or majority shareholders (holding at least 20% of voting rights) and a listed company, the respective board member or the majority shareholder should refrain from voting with respect to such transaction.* • *It appears that a few penalties have been imposed by courts or regulators in cases of misuse of corporate assets or of unauthorised/undisclosed related party transactions over the last 10 years. For instance in 2013, one of the largest banks by assets was sanctioned for non-disclosure of related party transaction*

Key Areas and Rating	Strengths and Weaknesses
	with 1,000 GEL (approximately EUR 450) and in 2007 another bank was sanctioned for related party transaction with approximately 700,000 GEL (approximately EUR 318,000). ***Weaknesses:*** • *When looking at the websites of the ten largest listed companies, we found that nine companies disclosed information on related party transactions in their financial statements on their website. However, it appears that disclosure is generally poor (this is highlighted also by the above mentioned World Bank Report). Major issues include inadequate or non-existent disclosure and inappropriate accounting for related party commitments in a business combination.* • *There is no requirement for the (independent) audit committee to review related party transactions.*

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Key Areas and Rating	Strengths and Weaknesses
4. Rights of Shareholders *Fair*	*Minority shareholders are entitled to call a general shareholders meeting (GSM) and ask questions at the GSM. Furthermore, shareholders are endowed with pre-emptive rights in case of capital increase. Supermajority is required to approve major corporate changes. Shareholders are also entitled to bring a derivative claim, but it depends on the approval of shareholders. It is not clear if shareholders can propose new items to the GSM agenda or if they have inspection rights.* *Insider trading and self-dealing are regulated by law, but there is little evidence of implementation and enforcement.* *Supermajority is required to approve major corporate decisions. Cumulative voting is foreseen to appoint members of the supervisory board and it seems to be used in practice.* *Share registers of companies with more than 50 shareholders and listed companies should be maintained by an external independent registrar. Significant shareholding variations must be disclosed. Shareholders agreements do not need to be disclosed. It is not clear whether they are enforceable, since they seem to be very rare in practice.*
4.1. General Shareholders' Meeting (GSM) *Fair*	***Strengths:*** • *By law, shareholders representing 5% of the shares can call a GSM.* • *By law, notification with the agenda of the GSM needs to be sent to the shareholders at least 20 calendar days before the meeting.* • *Shareholders can submit questions in advance and ask questions at the GSM.* • *Shares carry voting rights in proportion to their value.* ***Weaknesses:*** • *Electronic voting and voting by post are not possible.* • *There is no requirement to make any documents or drafts decisions available for the GSM.* • *Only three companies published the GSM notifications on their website. Only one of these three companies posted materials for the GSM on its website.* • *It is not clear if shareholders can propose new items to the GSM agenda.* • *No company among the ten largest companies provides information about exercise of voting rights by its shareholders.*
4.2. Protection against Insider Trading and Self-dealing *Fair*	***Strengths:*** • *Insider trading is regulated and prohibited by law. Violation of this prohibition may lead to fines or imprisonment for up to three years.* • *Self-dealing is regulated by law. If the company plans to buy or sell assets or services from any shareholder, director, officer, employee, agent or representative (or any persons or company related to above), the board of directors must ensure that the price to be paid by the company for such assets or services is fair. Under the law, transactions made by companies, which are not based on fair market values, could be made invalid. However, it appears that there is no clear and consistent case law invalidating these transactions.* ***Weaknesses:*** • *We found no evidence of enforcement of insider trading legislation.* • *It appears that transactions in companies' shares do not need to be disclosed.*
4.3. Minority Shareholders Protection and Shareholders' Access to Information *Weak/Fair*	***Strengths:*** • *Shareholders have pre-emptive rights in all cases of capital increase. These rights could be waived at the GSM by a 3/4 qualified majority vote of all present shares.* • *A supermajority is required for major corporate decisions and to amend the articles of association. Minority shareholders may block major corporate changes with a 25%+1 vote.* • *Cumulative voting is foreseen by law to elect members of the supervisory board. Respondents to our survey believe that cumulative voting is commonly used.* ***Weaknesses:*** • *Only six among the ten largest companies posted their annual reports with financial and non-financial information online. The annual reports of the other four companies include only financial information. All ten companies in our sample published annual reports in English.* • *It appears that the law does not specifically refer to availability for shareholders' inspection of any kind of corporate documentation.* • *Derivative suits are possible, but they are conditional upon majority of voting shares present at the GSM, which is not easy to be reached in a jurisdiction with such a concentrated ownership structure as Georgia. In fact, it appears that this practice is not widely used.* • *Non-financial information include in the annual reports is sometimes limited and incomplete.*

Key Areas and Rating	Strengths and Weaknesses
4.4. Registration of Shareholdings *Moderately Strong*	***Strengths:*** • *By law, the share register of companies with more than 50 shareholders and listed companies should be maintained by the external independent registrar.* • *As a rule, free transferability of shares cannot be restricted. The National Bank of Georgia can restrict it when some legal provisions are violated.* • *Any acquisition of five per cent or more of the voting rights in a listed company and any change of five per cent or more to a shareholding originally reported needs to be reported to the regulator. Notification about substantial acquisition of securities must be submitted to the National Bank within 15 days from the date the level of beneficial ownership is exceeded. If a person fails to inform the regulator and the issuer or relevant exchange about substantial acquisition of securities, he or she may not use all voting rights attached to such securities at the next GSM.* ***Weaknesses:*** • *Shareholders agreements do not need to be disclosed. It is not clear whether they are enforceable, since they seem to be very rare in practice.*

Key Areas and Rating	Strengths and Weaknesses
5. Stakeholders and Institutions *Weak/Fair*	*The institutional framework supporting good corporate governance needs improvement. The Georgian Stock Exchange has very low liquidity and does not seem to be in a position to promote good corporate governance standards. However, both the stock exchange and the regulator maintain a webpage with regulatory submissions by listed companies.* *There is a very limited presence of international law firms and credit rating agencies, which usually provide some contribution to enhancing corporate governance. There is no corporate governance code for companies.* *The Corporate Governance Code for Banks was adopted in 2009, with no subsequent revisions. It operates on a "comply or explain" basis. There are however, no mandatory requirements to this end and in practice the Code seems to be disregarded.* *Judicial practice on corporate governance issues seems to be limited.* *The National Bank of Georgia is the supervisory authority and the regulator for the whole financial market in the country; it has the authority to address corporate governance failures and compel appropriate remedial action.* *International organisations' indicators place the country very well in terms of strength of investor protection, and relatively well on corruption perception and competiveness.*
5.1. Corporate Governance Structure and Institutions *Weak*	***Strengths:*** • *The Georgian Stock Exchange (GSE) is the officially recognised stock exchange in the country. The GSE is the only organised securities market in Georgia, and has been regularly trading since March 2000.* • *The stock exchange and the regulator provide for websites with regulatory submissions by listed companies (www.nbg.gov.ge and www.gse.ge). The annual and semi-annual reports of the companies listed/admitted to trading on the Georgian Stock Exchange (GSE) are available on www.gse.ge/stocks/reports.asp . However, these reports are available only in Georgian.* • *International audit firms have a significant presence in the country.* ***Weaknesses:*** • *The GSE has limited capitalisation (6% of GDP as per the 2012 World Bank data) and liquidity. Frequently, there are no daily trades. As pointed out by the above mentioned World Bank Report "Developing the domestic capital market will ease constraints for firms, by providing an alternative source of funding".* • *It appears that there is no segment at the stock exchange requiring listed companies to have a significantly higher corporate governance standards than those required for other listed companies. There are two types of companies trading on the stock exchange. The first type is composed of companies admitted to a trading system with no particular requirements; while the second type consists of officially listed companies (three companies at the time of the assessment).* • *The World Bank Report points out that "demand for high-quality financial statements is still limited overall. The Georgian capital market remains rather shallow, with banking sector dominating the financial sector. Georgian banks tend to give very little value to proper financial reports furnished by potential and existing borrowers, mainly relying on loan collateral. Collateralization requirements in Georgia averaged 223% of the loan values, and are partially caused by the lack of credibility and transparency of the financial information presented by borrowers".* • *The presence of international law firms and rating agencies is limited in Georgia.* • *It appears that there are no providers of corporate governance training.*
5.2. Corporate Governance Code *Weak*	***Strengths:*** • *There is a Corporate Governance Code for Commercial Banks developed by the Association of Banks in 2009. The Code provides for some good guidance on a number of issues which are not well regulated by law.* ***Weaknesses:*** • *There is no corporate governance code or other guidance applicable to companies.* • *The Corporate Governance Code for Commercial Banks is – by wording of the Code - to be implemented according to the so-called "comply or explain" approach, however, there are no mandatory requirements to this end and - even if all major banks have declared to share the provisions of the Code and expressed their readiness to implement it - in practice the Code does not appear to be taken as a reference.* • *The Code for Commercial Banks has not been revised since its adoption.* • *None of the ten largest companies or banks include any comply or explain statements in their annual report.* • *The implementation of the Code does not appear to be monitored.* • *We have no evidence of courts referring to the Code as a source of obligations or rights.*

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Key Areas and Rating	Strengths and Weaknesses
5.3. Institutional Environment *Fair*	***Strengths:*** • *According to the 2015 EBRD Assessment on Accessibility of Court Decisions ,it seems that case law is easily accessible to parties while the ease of access for public is lower , with the lack of prompt publication of court decisions and inefficiency of relevant court employees highlighted as key weaknesses.* • *The National Bank of Georgia (NBG) is the supervisory authority and the regulator for the whole financial market in the country. The NBG has the authority to address corporate governance failures and compel appropriate remedial action.* • *The Doing Business Index 2014, which ranks economies on their ease of doing business, positions Georgia on the 15th place among 189 economies based on the strength of investor protection index.* ***Weaknesses:*** • *It appears that there are a few major inconsistencies between laws and regulations in corporate governance matters. Further, a number of key issues appear to be unregulated (e.g. audit committee).* • *As far as other Indicators by International Organisations are concerned, the World Economic Forum's Global Competitiveness Index 2013-2014 places Georgia at the 72nd place among 148 economies. Finally, the Transparency International's Corruption Perceptions Index (CPI) ranks Georgia on the 52nd place among 176 countries.* • *Among the major issues identified in the 2015 EBRD Assessment on Accessibility of Court Decisions was the lack of prompt publication of court decisions and inefficiency of relevant court employees.*