TECHNICAL ASSISTANCE REPORT

REPUBLIC OF ARMENIA

Strengthening State-Owned Enterprises Accountability Framework

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Abbreviations and Acronyms

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

Preface

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

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

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

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

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

Executive Summary

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

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

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

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

Implementation of good corporate governance practices in Armenian SOEs will be key to improving their performance. While many important legislative improvements, including the adoption of the Corporate Governance Code (based on a “comply or explain” principle), have been introduced over the past few years, SOE corporate governance practices remain weak. Weaknesses include low independence and engagement of boards, minimal presence of board committees, and underdeveloped control functions. These significantly reduce SOE autonomy and efficiency. The implementation of good corporate governance practices, including strengthening the boards by adding independent professionals with strong industry expertise, should be mandated and enforced for the priority SOEs.

The Armenian SOE sector is dominated by legacy companies[1] with one notable exception – the Armenian National Interests Fund (ANIF) — established in 2019. ANIF, wholly owned by the Government, holds a very broad mandate summarized as (a) generating additional income for RA and (b) contributing to the economic development of Armenia. ANIF's investment initiatives and projects range from the hospitality industry to consumer finance and large infrastructure projects. Due to very limited disclosure, it is impossible to assess the viability and rationale of ANIF's investment initiatives. The information on how the investment choices relate to the company's mandate/strategy, the outcomes and financial performance of these investments, investment and risk policies are either lacking or are not publicly available. ANIF and its two subsidiaries are 100% funded from the state budget. After carefully examining the corporate governance of ANIF against global best practices, this mission concluded that it remains relatively immature today.

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

Table 1 summarizes the key recommendations of this mission.

Table 1. Key Recommendations

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

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

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

I. SOE Landscape in Armenia

A. Overview of Public Sector Units

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

Table 2. Armenia's SOE Portfolio[2]

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

Source: MoF, SPMC, Mission compilation

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

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

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

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

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

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

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

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

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

B. SOE Landscape

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

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

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