

**GEORGIAN YOUNG LAWYERS' ASSOCIATION**

**TRANSPARENCY AND  
ACCOUNTABILITY  
OF STATE OWNED COMPANIES**



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## 1. GOALS AND MOTIVES

Over the last few years the state was actively founding commercial and non-commercial legal entities, most of which were delegated with important public service authorities. Further, a number of large-scale projects funded by the state budget were implemented with direct involvement of these legal entities, while a significant portion of public property transferred to the legal entities according to applicable regulations remains under their management and control.

Despite the fact that commercial and non-commercial legal entities owned by the state were (are) actively involved in a number of projects, their standards for transparency and accountability are rather low and in some cases non-existent. Regrettably, no systemic changes have been made for establishing a high standard of transparency for commercial and non-commercial legal entities owned by the state.

Notably, problematic nature of the issue was also highlighted by the third report of the Organization for Economic Cooperation and Development (OECD).<sup>1</sup> For instance, according to the OECD report, due to the lack of transparency, exception from public procurement rules and appointments without competition, state-owned enterprises are prone to corruption risks.<sup>2</sup>

The foregoing issues are only a small part of motives to perform this research.

The present research aims to:

- Analyze applicable legal base for state-owned legal entities;
- Obtain and categorize information about state-owned legal entities by state shares in enterprise and enterprise functions;
- Provide an overview of the state-owned enterprises according to their status (active, inactive) and capital;
- Evaluate transparency and accountability standards of these enterprises (e.g. internal documents providing standards of ethics, internal audits, prevention of corruption, managerial appointments with competition, etc.)
- The role of the National Agency for Management of State Property and its importance in dealings with state-owned legal entities. Strategy of the Agency and standards of transparency and accountability within the strategy.

The research does not include legal entities founded by local self-governments or enterprises that have been founded by the state but transferred to public or private persons with management rights.

## 2. METHODOLOGY

While working on this research, GYLA utilized the following methods:

- General analysis of the existing legal base
- Requesting access to public information from the administration of the Government, Ministries and the State Agency for Management of State Property

The research entailed detailed analysis of the information obtained; in addition, GYLA analyzed part of the property declarations of government officials retrieved from [www.declaration.gov.ge](http://www.declaration.gov.ge), relevant to annual income of managers (directors) of state-owned legal entities. It also monitored the website of state-owned enterprises with a capital of over a million laris.

## 3. KEY FINDINGS

Important findings of the research include:

- In 2013, 13% of 373 state-owned legal entities were commercial.<sup>3</sup>
- There are no special regulations that would establish at least a minimum standard of transparency for state-owned legal entities.
- In 2014<sup>4</sup>, 52 directors/heads of state-owned legal entities have submitted their property declarations, according to which their total income received as a remuneration for their positions is 1,455,305 laris.

<sup>1</sup> <http://www.oecd.org/corruption/acn/GEORGIAThirdRoundMonitoringReportENG.pdf>;

<sup>2</sup> OECD 3<sup>rd</sup> Round Monitoring Report, p.102-103;

<sup>3</sup> Percentage shares calculated from the number of state enterprises in 2013 (373 entities)

<sup>4</sup> Information was published in 2014 and reflects incomes from previous year

- Total assets of public entities managed by the National Agency for Management of State Property where government has shares amounts to **922,265,390** laris and **244,560**US dollars. Among these entities, the State Service Bureau has the largest beginning capital amounting to 226,355,957 laris. Nevertheless, the company does not even have a website.
- In 2013-2014, the Government of Georgia adopted 20 resolutions providing special regulations for state procurement for entities including Electro Systems of Georgia JSC, Georgian Foundation for Development of Energy JSC, Tbilaviamsheni Ltd, Georgian Post Ltd, Engurhesi Ltd., Georgian Lottery Company Ltd and others.
- The nature of information that the National Agency for Management of State Property is trying to obtain by having public entities fill out a template form is mostly financial. The purpose of collecting the information by means of the template is to restore viability of state-owned legal entities and their assessment for future reorganization. However, the information collected through the template cannot be viewed as an effective mechanism for preventing and combating corruption.
- There are no templates, terms and conditions for annual reporting, which has an adverse impact on full access to public information about the entities.
- Among the entities where the state has shares and are operating under direct supervision of the National Agency for Management of State Property, 14 have ethics regulations and perform self-evaluation research, while 11 entities have rules of ethics only.
- None of the entities managed by National Agency for Management of State Property had competitions for managerial appointments. Regrettably, appointments by competition is not mandated by law, while absence of competition allows filling of managerial positions by autocratic decisions, based on personal relationships.
- The Agency does not have accurate information about the number employees of public entities, which is indicative of lack of accountability on part of legal entities.
- According to the Agency, in 2012-2013 the state transferred 271 public entities to local self-governments and 27 public entities to various individuals (including Ministries and private companies) with rights to manage.
- Most of the entities where the government owns a share does not have websites; neither do they practice proactive publication of information about past events, future plans, annual reports, etc.

#### 4. LEGISLATION OF GEORGIA

As provided by the Civil Code of Georgia, there are two categories of persons: natural persons and legal entities.<sup>5</sup>Article 24 of the Code provides for the concept of a legal person which is an organized entity, created for the accomplishment of a certain objective and having its own property under its ownership that is independently liable with its own property, acquires rights and duties in its own name, makes transactions and can sue or be sued.<sup>6</sup>

There are several types of legal entities. It may be a corporate, membership based, dependent on or independent from members' condition, commercial or non-commercial and etc. Notwithstanding these difference, we can find some key features: every legal entity is set up for achieving certain objectives and serves this purpose. Furthermore, all legal entities have an organized form, which means that it is established for implementation of multiple actions for a long term. Property of the legal entity is separated from the property of its founder and etc.

Legal entities are divided into legal entities of public law<sup>7</sup> and legal entities of private law. Private Law Entities are established on the basis of free expression of a will by founders and the parties' autonomy. Legal entity of private law is entitled to carry out any activity that is not prohibited by law, regardless of whether the activity is envisaged in the foundation documents or not. Private law legal entities include two groups: commercial legal entities aiming to carry out commercial activities and noncommercial legal entities which do not implement entrepreneur activities. They are also called legal entities with ideal purpose. Legal entities which aim to follow commercial activities should be established as per the Law of Georgia on Entrepreneurs,<sup>8</sup> whilst a legal entity which does not follow commercial activities should be registered according to the rules envisaged

<sup>5</sup> Civil Code of Georgia, Chapter first.

<sup>6</sup> Civil Code of Georgia, Article 24 .

<sup>7</sup> Since the subject of the research is state founded commercial and non-commercial legal entities, will not focus on the concept of legal entity of public law and its regulatory norms.

<sup>8</sup> Civil Code of Georgia, Article 24, Para 5.

by the Civil Code of Georgia.<sup>9</sup>

Business entity is a profit oriented enterprise with a major aim to carry out commercial activities. As provided by Entrepreneurs Law of Georgia, commercial activity shall be a legitimate and repeated activity carried out independently and in an organized manner to gain profit.<sup>10</sup> As provided by the same law, business entities shall be: an individual entrepreneur, a general partnership (GP), a limited partnership (LP), a limited liability company (LLC), a joint-stock company (JSC, corporation) and a cooperative.

The state can establish commercial entities through LEPL National Agency of State Property (later referred to as Agency) under the system of the Ministry of Economy and Sustainable Development of Georgia.<sup>11</sup> Though, the state is entitled to establish only two types of entities: Limited Liability Companies (LLC) and Joint Stock Companies (JSC).<sup>12</sup>

The state, along with establishing concrete commercial entities, may also possess shares and stocks that may be registered as state property in the Register of Commercial and Non-commercial Legal Entities. Shares and stocks belong to intangible assets.<sup>13</sup>

Apart from the rights and obligations envisaged by the legislation, the state has additional opportunity to set up a Supervisory Board by the government decision in the entity where it possesses more than 50% of total votes.<sup>14</sup> In such case civil servant may be a state representative in the Supervisory Board unless it he/she has conflict of interests in the entity concerned. Members of the Supervisory Board who are also civil servants fulfill their obligations without any remuneration and their activity shall not be viewed as conflict of interest in the civil service. In a joint stock company, in which the state holds more than 50 % of total votes, the Supervisory Board must coordinate the appointment and dismissal of directors with the state authorized person. In case of disagreement between the Board and shareholders, the decision on appointing and dismissing a director shall be made by the General Assembly.<sup>15</sup>

#### **4.1. National Agency of State Property**

As stated in this research, the state is authorized to possess, use and manage property under its ownership, without violating interests of other individuals. The state realizes the above rights through the National Agency of State Property, which is a legal successor of the Agency for Management of Enterprises and has been functioning with its current status since September 17, 2012.<sup>16</sup>

The purpose of the Agency, a legal entity of public law under subordination of the Ministry of Economy and Sustainable Development, is fulfillment of authority of a partner (share holder) in enterprises where the state owns shares. Consequently, as a partner it is entitled to make the following decisions:<sup>17</sup>

- Changes in capital of enterprises where the state owns shares;
- Adoption of a business plan of enterprises;
- Taking loans or credits by enterprises;
- Founding/liquidating branches of enterprises;
- Distributing net revenue of enterprises within the scope of their competences;
- Initiating proceedings for reorganization, liquidation, rehabilitation and bankruptcy of enterprises;
- Transfer of enterprises into temporary ownership, write them off, selling them, use them as a collateral loans and other types of credit envisaged by the Civil Code of Georgia.

The agency discharges its authority about shares and stocks that it manages by means of its structural divisions, including:

<sup>9</sup> Civil Code of Georgia, Article 24, Para 6.

<sup>10</sup> Entrepreneurs Law of Georgia, Article 1, Para 2.

<sup>11</sup> Article 3 of Government order # 391, of September 17, 2012 about approval of the charter of the LEPL National Agency of State Property;

<sup>12</sup> Law of Georgia on State Property, Article 39, Para 2.

<sup>13</sup> Para 1, Article 39 of the Law on State Property of Georgia

<sup>14</sup> Para 8, Article 8 of the Entrepreneurs Law of Georgia

<sup>15</sup> Entrepreneurs Law of Georgia, Article 55, Para 7, clause f)

<sup>16</sup> September 17, 2012 Order #391 of the Government of Georgia on the Adoption of Regulations of Legal Entity of Public Law – National Agency of State Property, Article 3

<sup>17</sup> „September 17, 2012 Order #391 of the Government of Georgia on the Adoption of Regulations of Legal Entity of Public Law – National Agency of State Property, Article 3, para.1s.

- **Analytical Department.**<sup>18</sup> Its key functions include: financial analysis of enterprises managed by the Agency and presenting recommendations/proposals based on the analysis to the Agency;
- **Service for Management of State Enterprises of the Department of Service Support.**<sup>19</sup> Its key functions include: undertaking of measures related to founding commercial and non-commercial entities, discharging obligations of a partner in enterprises managed by the Agency and managing their shares/stocks and property;
- **Service of Relations with Court of Legal Department.**<sup>20</sup> Its key functions include: representation in civil, administrative and criminal cases involving state-owned enterprises, if the Agency is a party, including the third party. Further, authorized manager of the enterprise concerned must inform the Agency of proceedings brought against the administrative agency within two weeks before the proceedings are instituted. Further, authorized manager of the enterprise concerned must provide written information to the Agency about the dispute in which the enterprise is a party within a week after receiving court's notice.<sup>21</sup>

#### ***4.2. National Agency of State Property, as an Effective Manager of the Enterprises – Practical Aspects of its Work***

The analysis of powers that the Agency has been delegated with leads us to conclude that it is one of the key players in management, use and supervision of the state-owned enterprises, especially ones where the state owns over 50% of shares or stocks. Therefore, it is important to examine its work and future goals. This will help us evaluate the existing situation, steps forward or problems that remain.

According to the 2013 report of the Agency, for the purpose of examining situation and prospect of development of state-owned enterprises, Strategy for Management of Enterprises 2014-2015 was elaborated.<sup>22</sup> The strategy had the following four objectives:

- Recording assets of the enterprises and creating a unified database;
- Improving coordination and control mechanisms;
- Completing the process of optimization and minimization;
- Implementing strategic approaches and transferring the enterprises in private sector.<sup>23</sup>

During the first stage of implementation of the strategy, the Analytical Department of the National Agency of State Property implemented the following measures:

- A new template for collection of information was elaborated and sent to 84 existing companies;
- The enterprises were requested to submit their business plans for their review and adoption;
- An order was elaborated, mandating enterprises to compile inventory and reevaluate their assets, in order to determine their actual value.<sup>24</sup>

Based on the reports prepared by the Agency, collecting information from state-owned enterprises was problematic for delayed provision of information and poor quality of information provided. Analysis of the information obtained uncovered a number of deficiencies, including extremely weak financial management, enterprises that are unlikely to succeed if they continue to operate in their current form, a number of medical enterprises whose subsistence depend on funding of the state healthcare programs and more. A number of measures were planned for the next reporting period to address these problems.<sup>25</sup>

<sup>18</sup> September 17, 2012 Order #391 of the Government of Georgia on the Adoption of Regulations of Legal Entity of Public Law – National Agency of State Property, Article 12;

<sup>19</sup> September 17, 2012 Order #391 of the Government of Georgia on the Adoption of Regulations of Legal Entity of Public Law – National Agency of State Property, Article 14, para. 4;

<sup>20</sup> September 17, 2012 Order #391 of the Government of Georgia on the Adoption of Regulations of Legal Entity of Public Law – National Agency of State Property, Article 3, para.3a

<sup>21</sup> October 21, 2010 Order #1-1/1732 of the Ministry of Economy and Sustainable Development of Georgia on the Adoption of Regulations for Disposal of Fixed Assets in Capital or on Balance of Enterprises where the State Holds over 50% of Shares, para.3, Article 2.

<sup>22</sup> Annual Report of the Legal Entity of Public Law – National Agency of State Property in 2013-  
<http://nasp.gov.ge/res/docs/2014040315020211567.pdf>

<sup>23</sup> Second quarterly report of the Legal Entity of Public Law – National Agency of State Property in 2014-  
<http://nasp.gov.ge/res/docs/2014073118490255733.pdf>

<sup>24</sup> First quarterly report of the Legal Entity of Public Law – National Agency of State Property in 2014 -  
<http://nasp.gov.ge/res/docs/201405131023527785.pdf>

<sup>25</sup> First quarterly report of the Legal Entity of Public Law – National Agency of State Property in 2014 -  
<http://nasp.gov.ge/res/docs/201405131023527785.pdf>

According to the second quarterly report of the Agency in 2014, to improve coordination with enterprises and the mechanism of control, the agency began actively using the new template for collection of information and the method of financial analysis designed on the basis of the template. The new template for collection of information was sent to 82 companies. Timeframe and format for submission of information by the companies was determined. Recommendations were issued on a periodic basis about filling out of the data collection template.<sup>26</sup>

Particular attention was paid to collection and review of 2014 business plans. According to the existing information, only 66 companies were able to provide business plans, majority of which fell short of the requirements of the agency. To remedy the deficiency, the agency continues to actively work with company managements.<sup>27</sup>

According to the 2014 report of the Agency, in frames of the process of optimization and minimization, following liquidation, bankruptcy and reorganization of inactive enterprises, number of enterprises managed by the Agency was reduced by 36%.<sup>28</sup>

According to the same report, strategic objectives of the organization were modified and reformulated as follows:<sup>29</sup>

- Create effective mechanisms for management and a unified database;
- Ensure rational management of property;
- Transform into a service organization;
- Transform into effective manager of enterprises;
- Ensure transparency and accountability.

In view of the substance of the report, it is especially important to review implemented measures for transparency and accountability. According to the 2014 report of the Agency, these measures mostly entailed activities for development of the Agency web-site; in particular, all types of information about the Agency were published on the website; information about objects under the state ownership and up for privatization, and information about ongoing and past auctions.

To paint a comprehensive picture of the Agency's operations, GYLA requested access to additional information from the Agency, analysis of which suggests the following:<sup>30</sup>

- The Agency continues to work on elaboration of a long-term and extensive Strategic Plan, more responsive to current needs of the Agency. The plan will allow the agency to review its successes, challenges and develop new perspectives.<sup>31</sup> **Further, GYLA's request for accessing the strategy presented in 2013-2014 reports of the Agency was refused.**
- Based on the 2013 report of the Agency, methodology of evaluation of financial risks of enterprises means the following – **to evaluate financial risks of enterprises, the Agency selects criteria that are determined periodically. Based on the criteria, the agency develops risk index, while in the process of evaluation it uses hierarchical method of evaluation of criteria.**<sup>32</sup>
- Templates that enterprises must fill out for collection of data are mostly financial. Purpose of collection of data by means of templates is to determine viability of state-owned legal entities and their assessment for future reorganization. **Therefore, the template may not be viewed as a mechanism established to combat and prevent corruption;**
- **Among the entities where the state has shares, only 14 have ethics regulations and perform self-evaluation research, while 11 entities have rules of ethics only.**<sup>33</sup>
- **None of the entities managed by National Agency for Management of State Property had competitions for managerial appointments.**<sup>34</sup>

<sup>26</sup> Second quarterly report of the Legal Entity of Public Law – National Agency of State Property in 2014 - <http://nasp.gov.ge/res/docs/2014073118490255733.pdf>

<sup>27</sup> Second quarterly report of the Legal Entity of Public Law – National Agency of State Property in 2014 - <http://nasp.gov.ge/res/docs/2014073118490255733.pdf>

<sup>28</sup> Annual report of the Legal Entity of Public Law – National Agency of State Property in 2014 - <http://nasp.gov.ge/res/docs/2015012710061017385.pdf>;

<sup>29</sup> Annual report of the Legal Entity of Public Law – National Agency of State Property in 2014- <http://nasp.gov.ge/res/docs/2015012710061017385.pdf>

<sup>30</sup> October 24, 2014 letter of GYLA #-04/532-14

<sup>31</sup> November 10, 2014 letter #14/42875 of the National Agency of State Property

<sup>32</sup> November 10, 2014 letter #14/42875 of the National Agency of State Property

<sup>33</sup> December 2, 2014 letter#14/46445 of the National Agency of State Property

<sup>34</sup> November 10, 2014 letter #14/42875 of the National Agency of State Property

In light of the above, we welcome a number of effective measures undertaken by the Agency to improve operation, management and control of enterprises. However, certain problems remain and require further effort.

Transparency and accountability of government-owned entities is particularly problematic. Based on applicable legislation, enterprises are required to report to the Agency on annual basis;<sup>35</sup> however, template of the report does not exist; neither the terms and conditions of preparing the report, which has adverse impact on the process and increases the risk of flawed reporting.

Further, it is also alarming that majority of state-owned agencies do not have their own website; they do not publish information about past events, future plans, annual reports and similar issues proactively.

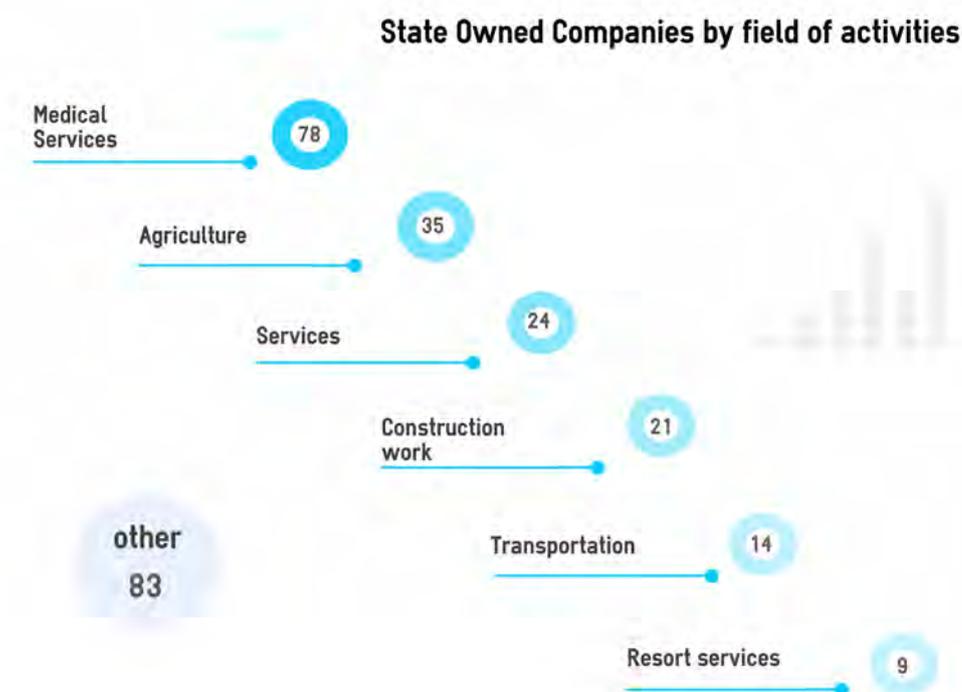
Despite the fact that ensuring transparency and accessibility is one of the strategic directions of the Agency, like we have stated above, it has nothing to do with ensuring transparency of enterprises themselves and is mostly directed at improving the website of the Agency.

## 5. LEGAL ENTITIES WHERE THE STATE HOLDS SHARES

The present chapter provides information about legal entities where the state holds shares and discusses legal issues related to their transparency and accountability.

### 5.1. State enterprises managed by the National Agency of State Property

Currently there are 264 enterprises managed by the National Agency of State Property (See Annex #1)<sup>36</sup>, including 146 specialized and 118 social enterprises.<sup>37</sup>

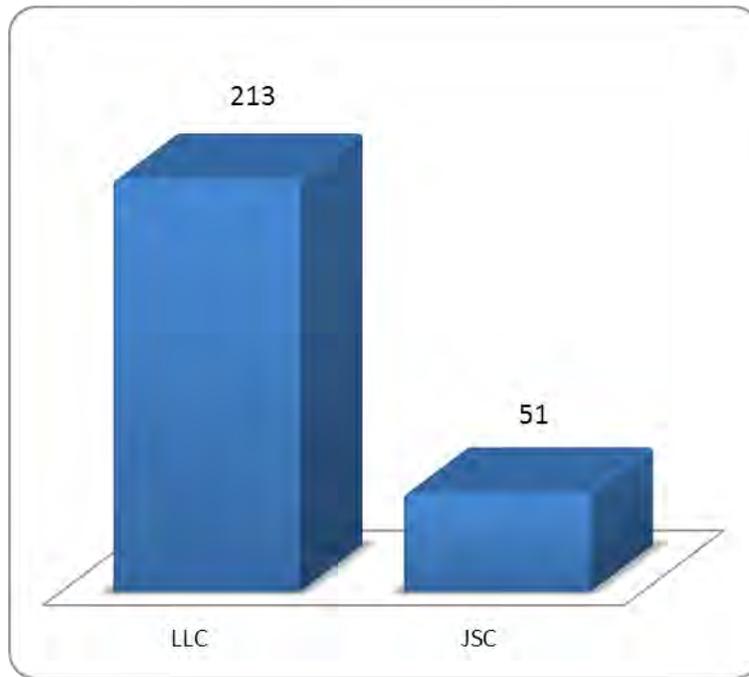


<sup>35</sup> September 17, 2012 Order #391 of the Government of Georgia on the Adoption of Regulations of Legal Entity of Public Law – National Agency of State Property, subparagraph “a”, Article 12, and October 21, 2010 Order #1-1/1732 of the Ministry of Economy and Sustainable Development of Georgia on the Adoption of Regulations for Disposal of Fixed Assets in Capital or on Balance of Enterprises where the State Holds over 50% of Shares, para.8, Article 4.

<sup>36</sup> <http://nasp.gov.ge/res/docs/201405191721401604.pdf> The monitoring group verified these entities at the public registry and found out that as of February 17, some of the entities from the list published by the Agency have been liquidated, reorganized or are in the midst of liquidation or reorganization. Therefore, they are not included in the present chapter. Two more entities were founded in 2014: Anaklia Ltd and State Food Provision Ltd, which are not included in the list published by the Agency

<sup>37</sup> 83 public entities are operating in the fields of industry, energy, trade, etc.

213 enterprises are limited liability companies, and 51 are joint stock companies.



Notably, in 2012-2014, 7 enterprises were privatized, generating the revenue of 2,244,001 laris.<sup>38</sup> Further, based on the information provided by the Agency, in 2012-2014, 267 enterprises were transferred to local self-government authorities with management rights, and 4 with ownership rights.<sup>39</sup>

Up to date (as of January 1, 2015) no information is available about the number of employees at enterprises managed by the National Agency of State Property.<sup>40</sup> However, as of January 1, 2014, based on information about 67 enterprises where the state owns more than 51% of shares (over 25% of existing state enterprises), number of employees is 7475.<sup>41</sup> Data about the number of employees in all remaining enterprises (about 75%) is nonexistent.

The above information clearly suggests that the Agency lacks the data about number of employees and legal entities where the state holds shares, which is indicative of weak accountability systems at these enterprises.

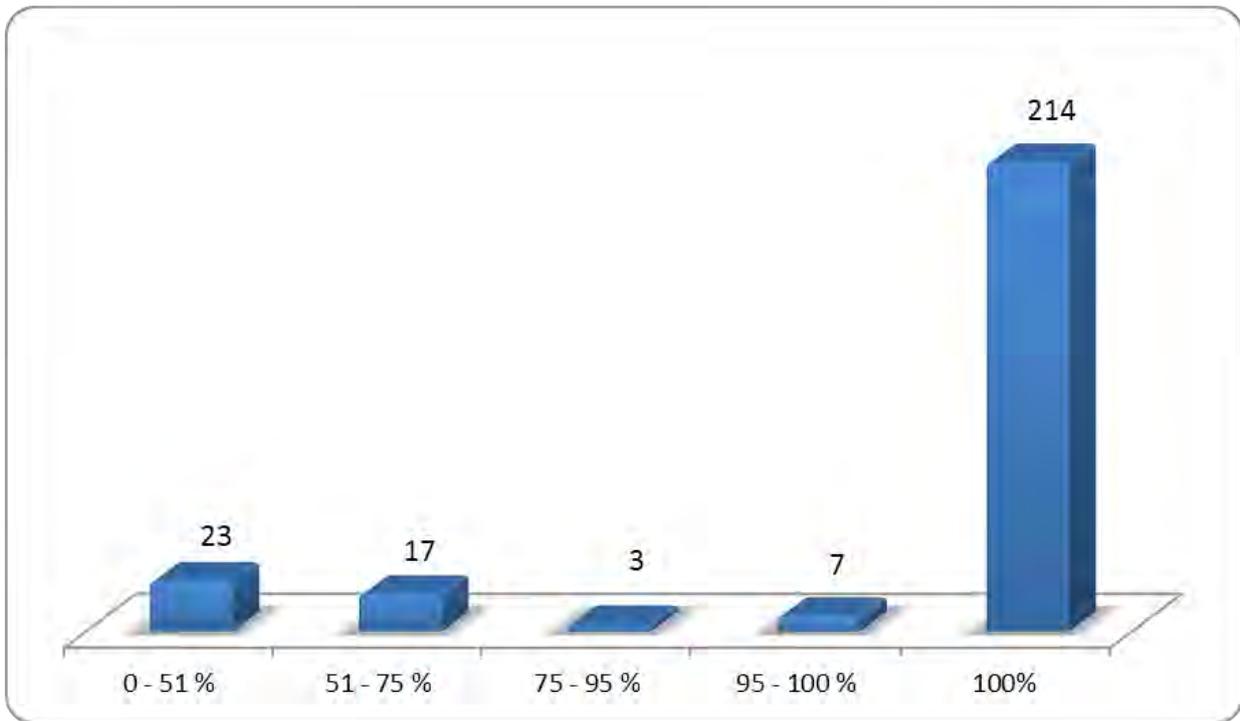
Considering that based on Law of Georgia on Entrepreneurs, holding of shares/stocks at an enterprise may have different legal implications, the present research acknowledges categorization of enterprises according to the amount of shares owned by the state:

<sup>38</sup> Letters from the National Agency of State Property #14/45228, dated November 24, 2014 and #14/12053, dated March 5, 2015

<sup>39</sup> Letters from the National Agency of State Property #14/45228, dated November 24, 2014 and #14/12053, dated March 5, 2015

<sup>40</sup> Letter from the National Agency of State Property #14/12053, dated March 5, 2015

<sup>41</sup> Letter from the National Agency of State Property #14/12053, dated March 5, 2015



- Owners of **5%** of the ownership capital have the right to demand for the special verification of the economic activity and the annual balance; right to hold for a special meeting; right to request from corresponding governing body copies of agreements concluded in the name of the company and/or information about pending agreements.<sup>42</sup>
- In companies where the state holds more than **50%** of votes, a supervisory board may be set up under the decision of the Government of Georgia. In the supervisory board, a public servant may serve as a state's representative if he or she has no conflict of interests with the company; s/he must also fulfill the obligations free of charge.<sup>43</sup>
- In a company where the state holds over **50%** shares, in an event of liquidation of the company, money received from selling its property must be deposited on the account of the company. It must also be authorized to spend the money to cover necessary expenses in the process of liquidation.<sup>44</sup>
- The existence of liability shall not suspend the registration proceeding in the process of reorganization of a company where the state owns over **50%** shares.<sup>45</sup>
- In a company where the state owns over **50%** of total votes, the supervisory board must coordinate the appointment and dismissal of directors with the holder of over 50% of company votes. In an event of disagreement between the board and the shareholders, the decision on appointing and dismissing a director shall be made by the General Meeting.<sup>46</sup>
- 75% of votes of the voting partner(s) present is required for passing a resolution to transform a joint stock company into a limited liability company or to merge companies.<sup>47</sup>
- Owner of over 95% of votes in a joint stock company may redeem the shares of the other shareholders for a fair value.<sup>48</sup>

<sup>42</sup> Article 53 of the Law on Entrepreneurs.

<sup>43</sup> Para.8, Article 9 of the Law on Entrepreneurs.

<sup>44</sup> Para.5, Article 14 of the Law on Entrepreneurs.

<sup>45</sup> Para.7, Article 14<sup>4</sup> of the law on Entrepreneurs.

<sup>46</sup> Subparagraph f<sup>1</sup>, para.7 of Article 55 of the Law on Entrepreneurs.

<sup>47</sup> Paras.3-4, Article 14<sup>4</sup> of the Law on Entrepreneurs.

<sup>48</sup> Para.1, Article 53<sup>4</sup> of the Law on Entrepreneurs.

### 5.1.1. Enterprises transferred with management rights

As noted in this research, a company founded by the state may be transferred by the National Agency for Managing the State Property to other subjects with management rights.<sup>49</sup> According to the Agency and 2015 findings of the Audit Service, 27 enterprises (legal entities) have been transferred by the state with management rights.<sup>50</sup>

The table below provides the list of companies that have been transferred with management rights:

	Title	Form F	Transferred share	Identification code	Managing entity
1	Tbilisi State Concert Hall	LLC L	100%	203836625	International Event LLC
2	Batumi Sea Port	LLC L	100%	245383678	Batumi Old Terminal Ltd.
3	Georgian film	LLC L	100%	202054196	Georgian Cinema Development Foundation LLC
4	SETI	LLC L	100%	435891126	Wellsford Horace LLC
5	Georgian Lottery Company	LLC L	70%	204568208	Georgian Post LLC
6	Wine Laboratory	LLC L	100%	202330398	LEPL Scientific Research Center of Agriculture
7	Social Rehabilitation Center of Disabled Individuals	LLC L	100%	202059388	The Defense Ministry of Georgia
8	Land Rehabilitation Agency	LLC L	100%	404406013	JSC Agricultural Corporation of Georgia
9	SPORTSHENSERVICE	LLCL	100%	204878542	The Ministry of Sport and Youth Affairs
10	Agricultural Corporation of Georgia	JSC	100%	404858285	The Ministry of Agriculture of Georgia
11	United Melioration Systems' Company of Georgia	LLC L	100%	204524568	The Ministry of Agriculture of Georgia
12	Tetnuldi Development	LLC L	100%	236049904	The Ministry of Regional Development and Infrastructure of Georgia
13	Infrastructure Development Company	LLC L	100%	220341324	The Ministry of Regional Development and Infrastructure of Georgia
14	Georgian United Water Supply Company	LLC L	100%	412670097	The Ministry of Regional Development and Infrastructure of Georgia
15	Solid Waste Company of Georgia	LLC L	100%	404942470	The Ministry of Regional Development and Infrastructure of Georgia
16	State Construction Company	LLC L	100%	205140257	The Ministry of Regional Development and Infrastructure of Georgia
17	Georgian Gas Transportation Company	LLC L	100%	206103722	The Ministry of Energy of Georgia
18	Engurhesi	LLC L	100%	251716371	The Ministry of Energy of Georgia
19	United Energetic System Sakrusenergo	JSC	50%	211324468	The Ministry of Energy of Georgia
20	Georgian Energy Development Foundation	JSC	100%	404391975	The Ministry of Energy of Georgia

<sup>49</sup> Overview of relevant legal base is provided in Chapter 4.2 of this research: management of shares and stocks under the ownership of the state.

<sup>50</sup> Letter #14/14466 from the National Agency of State Property, dated April 23, 2014

21	Telasi	JSC	25%	202052580	The Ministry of Energy of Georgia
22	Georgian Oil and Gas Corporation	JSC	100%	206237491	The Ministry of Energy of Georgia
23	Georgian State Electro System	JSC	100%	204995176	The Ministry of Energy of Georgia
24	Commercial Operator of Electricity System	JSC	100%	205170036	The Ministry of Energy of Georgia
25	Sachkhere regional Hospital – Union of Polyclinics	JSC	100%	239403463	The Union Dostakari
26	Alfa-Com	LLC L	100%	203829250	
27	Regional Healthcare Centre	LLC L	100%	236035517	The Ministry of Labor, Health and Social Affairs

Additionally, according to the Agency, 267 companies were transferred to local self-government authorities with management rights and 4 were transferred into their ownership in 2012-2014.<sup>51</sup>

## 5.2. Transparency and accountability of state owned companies

Freedom of Information Section of the General Administrative Code of Georgia does not directly provide for the definition of the state owned entities, though according to the same Code<sup>52</sup> public institution is an administrative body, as well as a legal person under private law with funding received from the state or local budget. Obviously, the definition also concerns state funded private entities and freedom of information regime is applied thereon. Nevertheless, information on these entities appeared on the web-page of the National Agency of State Property only in 2014, which may be viewed as a step forward. Though, we should note that new norms of pro-active publication of public information determined by government order #219 of August 26, 2013 do not entail foregoing entities. Moreover, there is no special regulation for ensuring transparency of these entities.<sup>53</sup>

Existence of accountability norms and their practical realization in different laws and by laws which also cover state owned entities also attracts attention. Below we submit information about practical implementation of those legislative acts with contain transparency and accountability norms.

### a) Submission of property declaration of high officials

Article 14 of the Law of Georgia on Conflict of Interest and Corruption concerns obligation of a high official to publish property declaration. The same law gives definition of a high official.<sup>54</sup> In November 2013 the new provision was added to the law and the scope of high officials extended, including also heads of the entities with 100% of funding from the central or local self-government budget, as well as heads of affiliates of these companies. In parallel to this amendment, on February 12, 2014 government adopted resolution #139 demanding submission of declaration by only those heads if company's turnover for previous year exceeds 100,000 laries according to annual profit declaration.<sup>55</sup>

As the web-page of the public service bureau illustrated,<sup>56</sup> in 2014 directors/managers of LLC/JSC have submitted total of 153 declarations in the period of 2014.<sup>57</sup> Among them only 52 were under management of the National Agency of State Property, which means that annual turnover of 80% of state entities was less than 100,000 laries in 2013. As it follows from submitted declarations, directors/managers of the state companies have receives 1,455,305 laris a year as reimbursement (see annex #2).

In addition, declarations were submitted by the those state companies which according to effectiveness audit of 2015 are under administration of the agency and don't function.<sup>58</sup> There are 16 entities and total income of

<sup>51</sup> Letters from the National Agency of State Property #14/45228, dated November 24, 2014 and #14/12053, dated March 5, 2015.

<sup>52</sup> Article 27 clause a) of the General Administrative Code of Georgia.

<sup>53</sup> Government resolution #219 of August 26, 2013

<sup>54</sup> Article 2 of the Law of Georgia on Conflict of Interest and Corruption in Civil Service.

<sup>55</sup> Article 33 of Resolution #139 of February 12, 2014 of the Government of Georgia.

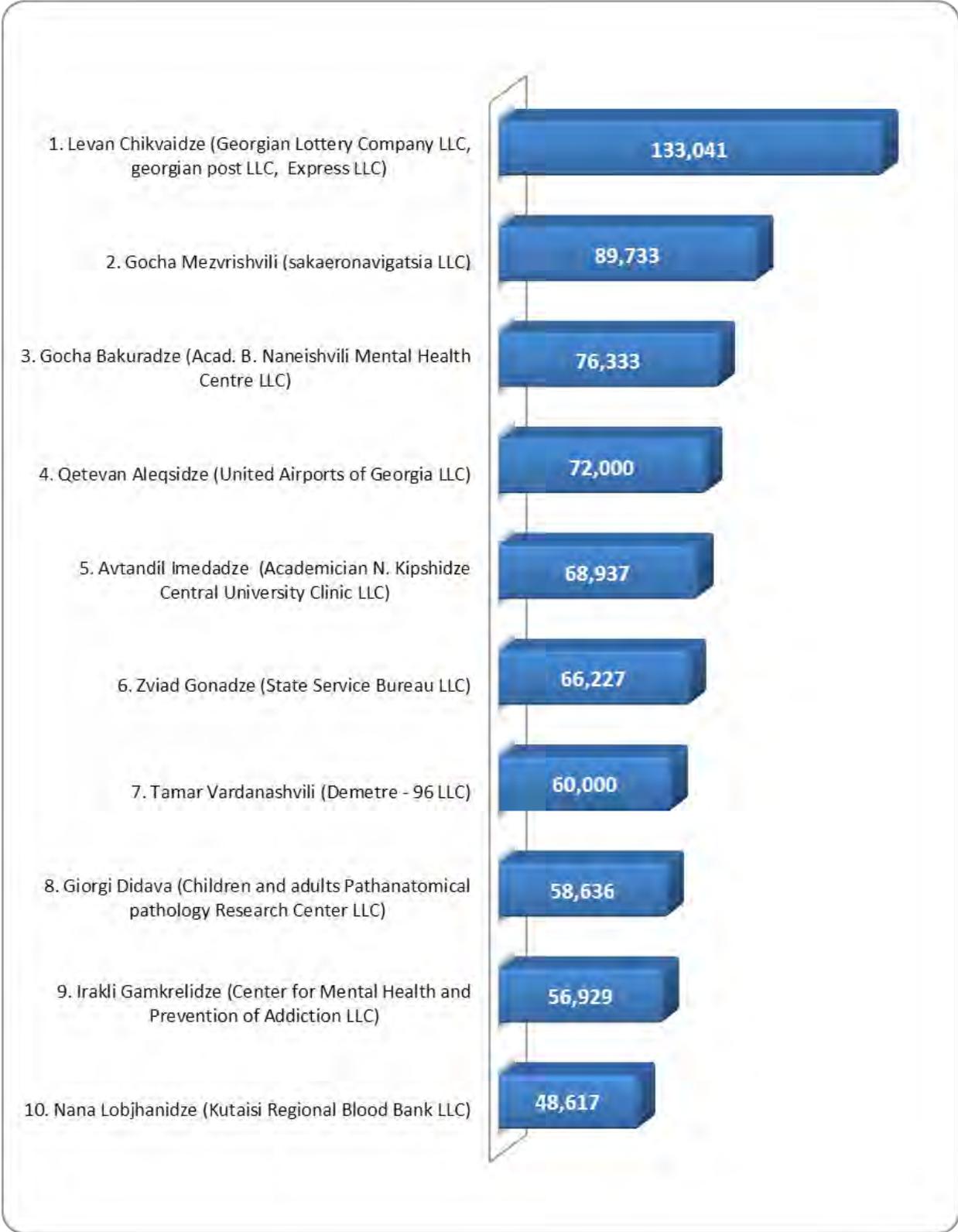
<sup>56</sup> [www.declarations.gov.ge](http://www.declarations.gov.ge)

<sup>57</sup> Declaration of Directors of 28 LLCs' does not contain information about their income.

<sup>58</sup> <http://sao.ge/files/auditi/efeqtianobis-angarishi/2015/sacarmota-martva.pdf>

management is more than GEL 300,000. Foregoing speaks about lack of transparency and information about entities by the Agency.

The diagram illustrates income of directors/managers with highest remuneration in state entities according to data given in property declarations:



## b) State Procurement

Another key factor of accountability and transparency is implementation of state procurements transparently and in compliance with law. According to the Law of Georgia on State Procurements,<sup>59</sup> state procurement is carried out with finances of entities with more than 50% of state share, though in view of specifics of the entities, if approved by the government, the law permits use of special rules of procurement.<sup>60</sup> The rule aims to simplify procurement procedures for goods and services. The special rule allows procuring entities to buy goods and services indicated in the government order with simple procurement by direct sale, negotiation with a single person and bidding. In all the listed cases the procuring entity carries negotiations itself, sets up bidding commission and makes contracts with a selected supplier. If other type of procurement is applied, it is carried out according to the Law on State Procurements.

According to the information of government administration, for the past two years the government adopted more than 20 orders about the special rule of procurement:

	Title	Date	number	period
1	Georgian Railway and companies established/functioning with its participation and companies established/functioning with their participation.	25.12.14	706	1 year
2	Soil Waste Management Company	19.09.14	560	1 year
3	LLC TBILAVIAMSHENI and its subsidiaries	12.09.14	554	2 years
4	LLC Georgian United Melioration System's Company	22.05.14	355	14 months
5	Georgian railway and companies established/functioning with its participation and companies established/functioning with their participation.	22.05.14	354	8 months
6	LLC Georgian United Water Supply Company	18.03.14	233	9 months
7	LLC"EXPRESS"	12.03.14	219	2 years
8	Engurhesi and Vardnilhesi cascade	20.02.14	191	2 years
9	LLC Marabda-Kartsakhis Railway	27.12.13	382	2 years
10	Georgian Post LLC	05.11.13	283	2 years
11	Georgian Lottery Company LLC	05.11.13	282	1 year amendment (12.03.14#220)
12	JSC Georgian Energy Development Foundation	18.09.13	241	2 years
13	"Tetnuldi Development" LLC	31.05.13	135	2 years
14	Hotel Anaklia LLC	17.05.13	122	2 years
15	Gas Transportation Company of Georgia LLC	06.09.13	228	2 years
16	JSC Georgian State Electro system	07.03.13	53	2 years
17	State Construction Company LLC	28.12.12	481	2 years
18	Demetre 96 LLC	24.12.12	474	2 years
19	Tbilaviamsheni LLC	06.09.12	363	2 years
20	Solid Waste Management Company of Georgia LLC	06.09.12	362	2 years

<sup>59</sup> Para 1, Article 3 of the Law of Georgia on State Procurements

<sup>60</sup> 3.1. a) state procurement – procurement of any goods, services and construction works by a procuring entity in the cases set forth in the present Law, through electronic or other means, with the following funds:

a.h) funds of an enterprise with more than 50% of stocks and shares owned by the State or a local self-government body, except when the mentioned enterprise when procuring goods or services related to the specificity of its operations is guided by a special rule established by the Government of Georgia for the procurement of these goods or services, which validity may not be over 2 years. The Ministry of Economy and Sustainable Development of Georgia or the Ministry of Regional Development and Infrastructure of Georgia, on the basis of the suggestions by relevant enterprises and local self-government bodies shall develop and submit to the Government of Georgia for approval a special rule to be established by the Government of Georgia. If the Government of Georgia does not prescribe a special rule, procurement shall be conducted pursuant to the present Law;

The chart demonstrates that provision of the law is conditional about restriction of the term and the government reapproves the special rule of procurement after expiration of the term. The state is not restricted by the law, therefore government has adopted similar decisions several times in terms of the same entities.

In addition, the law on state procurements does not restrict enterprises with state share to participate in state procurements as suppliers, which is competition with other private entities and stimulation of noncompetitive environment at the free market.

Another issue that should be reviewed in the context of state procurements is the case when the law on state procurements entitles the buyer to carry out procurement in a simplified way, if it is established by the legislative act of Georgia.<sup>61</sup> In 2013-2014 the government issued such acts in terms of 5 state enterprises which implemented 16 procurements on the basis of the document. These are the following entities:

1. United Airports of Georgia Ltd.<sup>62</sup> – 9 procurements;
2. Gudauri Development Agency<sup>63</sup> Ltd. – 4 procurements;
3. Georgian Teleradiocenter <sup>64</sup> Ltd.– 1 procurement;
4. The Universal Medical Center JSC <sup>65</sup> - 1
5. Anaklia Ltd.<sup>66</sup> – 1

According to the legislation, simplified state procurement is carried out as per legislative act of Georgia for conduct of events of state and public importance in restricted terms. However, the Law gives no definition of state and public importance. Accordingly, in each individual case, the government decides itself about granting the right to simplified procurement to the specific enterprise. In addition, the law sets no limits of simplified procurement. According to the government act, it may be carried out on any amount of funds. In view of this, simplified procurement reduces significantly publicity and competitiveness of state procurements.

### ***5.3. Property of entities where the state owns shares***

Based on the information provided by the National Agency of State Property, as of August 1, 2014, total assets of entities where the state owns shares amounts to **922,265,390**laris and **244,560**US dollars.<sup>67</sup> In the process of the research, we requested that the Agency provide latest information, as of January 2015, but such data does not exist.<sup>68</sup> Therefore, the figure below illustrates value of assets of 10 major companies, as of August 2014:

<sup>61</sup> Article 10 <sup>1</sup>, Para 3, Clause d of the Law of Georgia on State Procurements

<sup>62</sup> Government order # 2236 of December 10, 2014; # 1835 of October 9, 2014; # 1539 of September 5, 2014; # 1146 of June 26, 2014; #496 of March 26, 2014; #300 of February 20, 2014; #201 of February 10, 2014; # 1096 of August 21, 2013 and #516 of May 30, 2013.

<sup>63</sup> Government order #1493 of August 26, 2014; # 1492 of August 26, 2014; # 59 of January 16, 2014 and # 1509 of October 30, 2013.

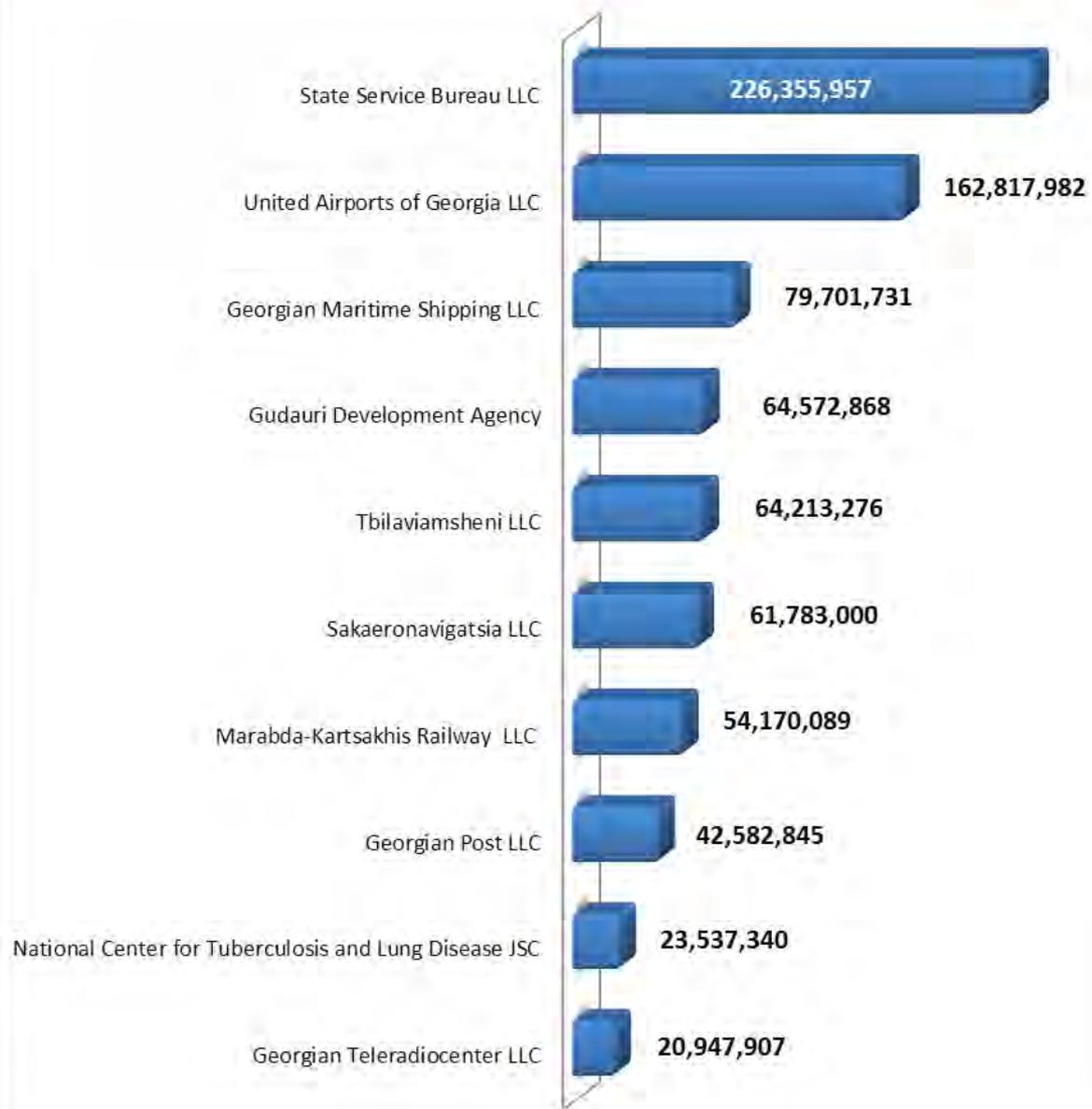
<sup>64</sup> Government order # 689 of April 14, 2014;

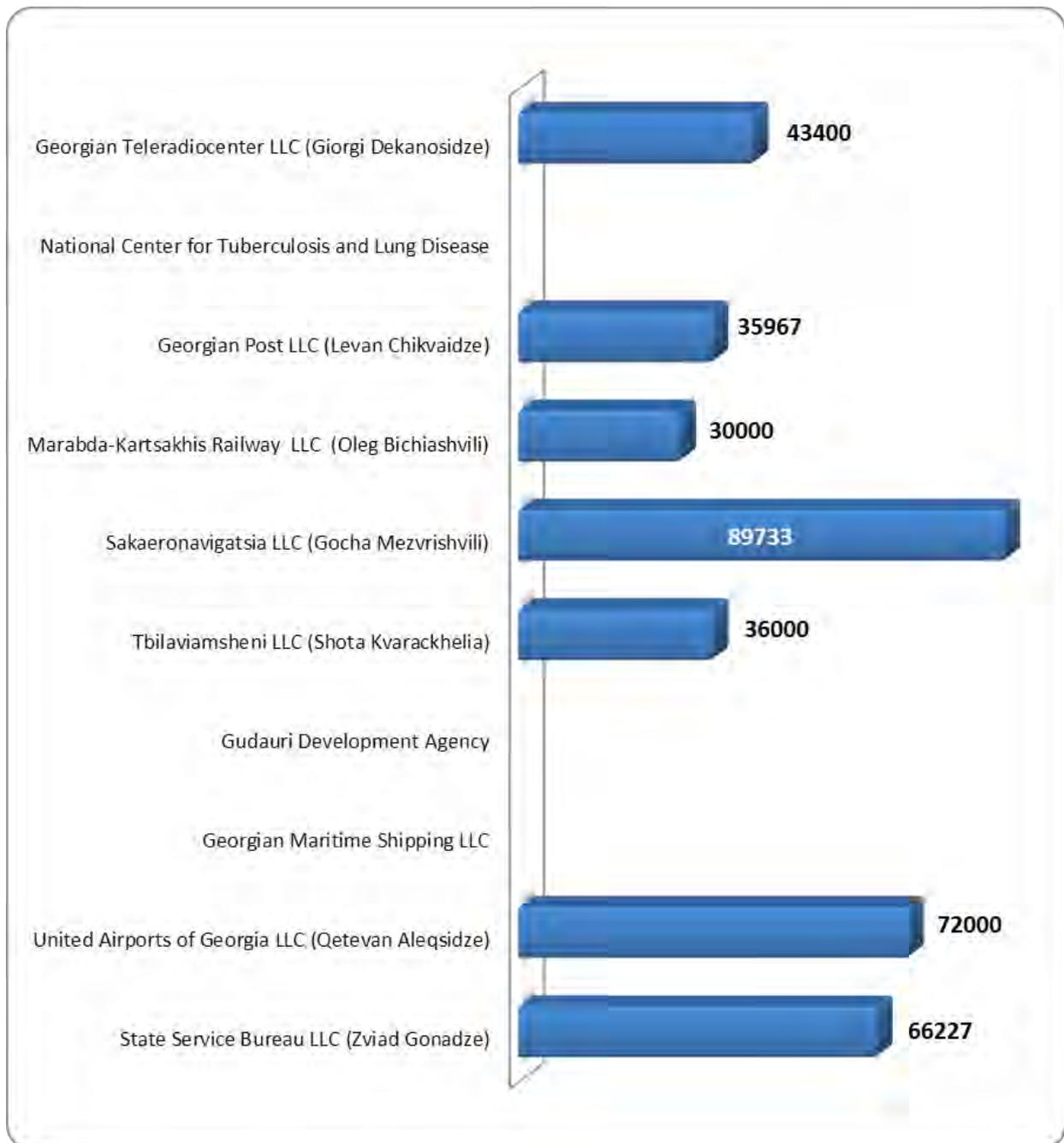
<sup>65</sup> Government order # 2409 of December 24, 2014;

<sup>66</sup> Government order # 1431 of August 14, 2014

<sup>67</sup> Information provided by the Agency about 183 enterprises, including 21 joint stock companies and 162 limited liability companies.

<sup>68</sup> Letters of the Agency # 14/30969 of August 19, 2014 and #14/12053 of March 5 #14/12053.





The diagram illustrates annual income of company managers/directors, according to their declarations, meaning that total annual turnover of these enterprises is over 100,000 laris. However, the diagram is missing information about the income of managers/directors of the following three major agencies, because they have not submitted their declarations:

1. Georgian Maritime Shipping Ltd. (value of assets over 79 million laris);
2. Gudauri Development Agency Ltd<sup>69</sup>. (value of assets over 64 million laris);
3. National Center for Tuberculosis and Lung Diseases JSC (value of assets over 23 million laris)

Public Service Bureau informed us that property declarations of managers/directors of the above companies are not available in the database, meaning that they did not submit their declarations.<sup>70</sup> Notably, in all three companies the state owns 100% shares. Considering the value of capital of all three companies, it is less likely that their annual turnaround was less than 100,000 laris. Notably, the National Agency of State Property does

<sup>69</sup> The Title of Gudauri Development Agency Ltd. was changed as a result of reorganization of October 8, 2014 and now it functions under the name of Mountain Resorts Development Company

<sup>70</sup> Letter #3193 from the Civil Service Bureau, dated April 23, 2015

not have the data about their annual turnaround.<sup>71</sup> This example clearly illustrates the low standard of transparency of state enterprises.

#### **5.4. Profitable companies**

According to the property declarations of high officials, annual turnover of 52 state companies in each case reached more than 1000000 laris. Though, from the agencies functioning under National Agency of State Property in 2013<sup>72</sup>, only 13% were profitable. Since the agency is not informed about the profits of 2014<sup>73</sup>, the below diagram illustrates number of profitable entities under National Agency of State Property in 2011-2013.

The Agency submitted information only on the basis of financial reports of 70 companies with more than 51% of state share. Their profit in 2011 reached 152,2 million laris, in 2012 - 12,5 million laris and in 2013 - 30,9 million laris.

According to the information provided by the National Agency of State Property, in 2011 the greatest portion of profit, 147,7 million laris fell on State Service Bureau Ltd, which received income after realization of the property. In next year no such privatization was carried out, while 2013 ended with loss of over 12 million laris.<sup>74</sup>

#### **5.5. Online Transparency of Enterprises**

One of the major factors of transparency of the state companies is availability of information in the internet, which is mainly ensured by web-pages in the modern world. When property of the state companies reaches billions of dollars, their accountability to public increases.

In view of this, online monitoring was carried out on all companies with capital of over 1000000 laris (total of 36 companies). It should be noted that "State Service Bureau" Ltd. which by 2014 was considered to be the largest company with assets of 226,355,957 laris has no web-page.

Out of foregoing 36 companies, only the listed 14 have a web-page, though they don't contain sufficient information ensuring transparency and accountability. Specifically they fail to release company accounts and frequently even their goals, vision and mission:

1. LLC "United Airports of Georgia"
2. LLC "Demetre 96"
3. LLC "Marabda-Kartsakhi Railway"
4. LLC "Regional Healthcare Center"
5. JSC National Center for Tuberculosis and Lung Disease
6. LLC "Sakaeronavigatsia"
7. LLC "Georgian Teleradiocenter"
8. LLC Georgian Post
9. LLC The National center of Mental Health
10. LLC Mental Health and Drug Abuse Prevention Center
11. JSC Infectious Diseases, AIDS and Clinical Immunology Research Center
12. LLC Technical Specialists Preparation Center
13. LLC "Sakavtotrans"
14. LLC Marine Technical Service

Even though some web-pages of the companies are available in the internet, they fail to meet transparency standards comprehensively. Some important aspect are omitted on most of web-pages, namely:

- None of the companies publish annual reports (audit and financial report and etc);
- Only few of them release information about the company's objectives, mission and vision, as well as about state procurements (biddings) or recruitment of human resources.

Finally, none of the large companies with a capital of over a million ensure adequate protection of transparency principle.

<sup>71</sup> Letter #14/12053 from the Agency, dated March 5, 2015

<sup>72</sup> 373 Entities.

<sup>73</sup> National Agency of State Property, Letter #14/12053 of March 5, 2015.

<sup>74</sup> Letter #14/12053 of March 5, 2015 of the National Agency of State Property

## CONCLUSION

The information provided in this research, allows us to draw the following several important conclusions:

- There are no applicable regulations that would establish at least minimum standard for transparency of state-owned enterprises;
- Activities of the National Agency of State Property with respect to enterprises where the state holds shares is not effective for combating and preventing corruption;
- Only a few among enterprises managed by the National Agency of State Property have their own ethics regulations or self-assessment documents;
- None of the enterprises managed by the Agency practice competition for appointments and regrettably, no such obligation is provided by the law. Absence of competition allows filling of managerial positions by autocratic decisions, based on personal relationships;
- Significant part of enterprises managed by the Agency are unprofitable;
- Accurate data about employees of the enterprises is not available, which suggests that their system of accountability is weak;
- There are no templates, terms and conditions for annual reporting, which has an adverse impact on full access to public information about the entities;
- Most of the entities where the government owns a share does not have websites; neither do they practice proactive publication of information about past events, future plans, annual reports, etc.

The state must take meaningful steps to improve transparency of enterprises where the state owns shares. These steps may include adoption and practice of ethics codes, regulations for prevention of corruption and internal audit.

A template, terms and conditions for annual reporting must be elaborated. It is also important that these reports provide an adequate account of issues related to transparency of the entities.

The authorities must analyze and introduce in practice the best international experience to improve transparency in entities managed by the state.