

# Russia & CIS Express

Quarterly bulletin from PwC's Russia & CIS Business Centre  
Winter 08/09

Special Feature – Financial Reporting

## In this issue

- Welcome
- Financial reporting
  - Being in control of the reporting agenda
  - Inside Russia – Imagine 'Real' Annual Report of a Factory (1997)
  - Positive momentum in reporting by Russian companies
  - The fund managers' perspective
  - The CFO's view
  - Thoughts from a Non-Executive Director
- Russian economic update
- Key facts and figures: Azerbaijan
- News from the Russia & CIS Business Centre



# Welcome



The economic downturn sweeping the world this winter will test the truth of an old Russian proverb which roughly translates as: “There cannot be bad without good”.

The consensus view is that in Russia there will be plenty of bad news, but perhaps out of the gloom there will also be a few glimmers of good news too – especially for nimble investors with a sharp eye for a bargain.

“It is quite clear that Russia, just like any country that is part of the global economy, is not going to escape the turmoil on the world financial markets unscathed,” said Jonathan Thornton, Transaction Services partner in PricewaterhouseCoopers Russia.

“But we believe Russia is in a stronger position than many of its emerging market counterparts to ride out the storm. And in the meantime, there are opportunities to be grabbed. We predict that a lot of assets are going to come onto the market at excellent prices,” added Thornton.

Since the summer, when Russian stock markets reached record highs, there has been a steady trickle of negative economic data.

Shares listed in Russia have lost about 80 percent of their value since peaks in May and some of the country’s biggest companies have had to seek assistance from the state to avoid defaulting on their foreign debt.

The price of oil on world markets – which had helped Russia sustain vigorous economic growth for years – dropped from above \$147 in July to under \$40 dollars now, putting downward pressure on the national currency, the rouble.

Finance Minister Alexei Kudrin warned that in 2009 the budget would move into deficit for the first time in a decade, while Standard and Poor’s Rating Services became the first ratings agency in a decade to downgrade Russia from BBB+/A-2 to BBB/A-3.

Prime Minister Vladimir Putin, in a recent speech that was broadcast on national television, made it clear there were tough times ahead.

**“It (the crisis) will test the mettle of every country, their ability to defend the fortunes of their citizens, the economy and the national currency. That challenge stands today in front of Russia,” said Putin.**

Few people could have predicted the scale or suddenness of the global downturn, but capitalising on several years of high prices for oil and other exports, the Russian government used the bumper revenues to create a bulging “rainy day fund”, and to build up the world’s third largest gold and foreign exchange reserves.

That war chest allowed the state to mount a vigorous fight back when the crisis hit. The central bank spent \$100 billion intervening in the currency markets since mid-August in an effort to maintain a stable rouble.

It assembled a package of measures worth a total of \$200 billion to improve liquidity in the banking sector, bail out indebted firms, and provide an economic stimulus.

“Like several developed economies, Russia’s government has supported its banking sector through loans and the purchase of shares” said Yael Selfin, Head of Macro Consulting in PricewaterhouseCoopers LLP (UK).

“What makes Russia different is that it has built up significant reserves that it can now draw on, so, unlike a number of economies, it does not need to resort to debt in the immediate future to finance its anti-crisis measures,” Selfin added.

While the government manages the slowdown, some investors are finding the new economic reality can work to their advantage.

One Western businessmen was about to complete a deal with a major investor to finance a real estate acquisition when the crisis hit. “The investor stopped answering my calls,” he said. “Silence is the worst thing.”

The investor pulled out of the deal, but what seemed like a disaster turned out to be an opportunity. With the crisis driving down real estate prices, the owner of the property the businessman was hoping to buy dropped his price and even agreed to provide a low-interest mortgage to finance the acquisition. “Now it’s all on again,” said the businessman.

That is not an isolated case. At a time when many companies could be forced to dispose of assets, market insiders predict an upsurge in mergers and acquisitions.

One of Russia’s richest men has already scented an opportunity. Former mining magnate Mikhail Prokhorov snapped up half of Renaissance Capital, one of Russia’s leading investment banks, for \$500 million – a deal widely viewed as a bargain.

It may be months off yet, but some investors are already looking ahead to opportunities that could arise when the Russian economy starts to emerge from the downturn.

“Things may seem gloomy now, but it is important not to forget about Russia’s medium-term prospects for growth,” said Martijn Peeters, Strategy Director at PricewaterhouseCoopers Russia”.

by the editors of Russia & CIS Express



**Nick Page**  
PricewaterhouseCoopers LLP  
nick.r.page@uk.pwc.com



**Liz Henson**  
PricewaterhouseCoopers LLP  
elizabeth.c.henson@uk.pwc.com

# Financial Reporting

In this edition of the Russia & CIS Express we examine financial reporting by Russian companies. More often than not companies considering investing in Russia ask about the reliability of financial information and annual reports issued by Russian companies.

In the following articles we attempt to dispel some concerns whilst also presenting a realistic position. In our first article David Phillips, a prominent commentator on Corporate Reporting confirms that companies throughout the world need to reflect on what they report and importantly how they articulate their fortunes and prospects. This is followed by two articles respectively commenting on financial reporting by Russian companies – the first article was published in The Moscow Times in December 1997 and portrays a cynical point of view, the second, by Richard Munn, Head of Assurance in PricewaterhouseCoopers Russia, provides a contemporary perspective. Finally we interviewed three professionals outside PricewaterhouseCoopers: Elena Shaftan, fund manager and Colin Croft, analyst at Jupiter Fund Management in London and a long time investor in Russian equities, Evgeny Logovinsky, CFO at Russian insurance company Sogaz and Tam Basunia, Non-Executive Director of STS, a leading commercial television station in Russia.

The overriding conclusion of this brief examination of financial reporting by Russian companies, is that there has been significant progress in the last 10 years, particularly by the larger companies many of whom have embraced international standards for reporting and disclosure as well as improving the speed of reporting to the market.

We hope that this short feature gives some comfort that financial reporting by Russian companies is following a positive trajectory.

# Being in control of the reporting agenda

The capital markets are particularly fragile at the current time with business confidence at an all time low. In this environment there is a tendency for markets to act first and then ask questions later.

Many companies believe that reporting has become a lottery, but arguably now is the time for companies to be really focused on their reporting and to recognise that mere compliance with the regulatory model is not good enough. Now is the time to approach reporting as a communication process, as a competitive tool which can help differentiate the good from the lucky. Adopting a compliance mindset to reporting in the current climate is unlikely to be well received by the market.

**This challenge to raise the bar on reporting is the same across the globe, whether a company is operating in Munich, Manchester or Moscow.**

The fundamentals do not change although what is accepted as normal market practice may do so. It is normally in times of adversity that company reporting becomes more transparent, the critical question is who is driving the process, management or hostile investors. The dynamic that results can be very different.

So what is it that companies need to focus on at these difficult times. Firstly companies need to ensure there is real transparency on the financial performance and position of the business. Most importantly, the market is interested in the fundamentals of cash flow performance, the funding position and the basis on which the business is considered a going concern. This information is often fragmented in company reporting and anything that can be done to consolidate relevant information in one place will be well received by investors.

Secondly, in considering all the information that needs reporting we must recognise that financial information, although important can not explain certain aspects of business performance. Investors are particularly interested in receiving management's perspective on the markets in which a company operates, the dynamic of their business model and the key risks and relationships which impact performance and success. None of this information is going to be delivered through conventional financial reporting so what more should be done. On the issue of the market environment, it is important to be able to explain how the market and competitive landscapes are anticipated to change and how this has impacted strategic thinking. On the business model the challenge is to highlight why it is robust and capable of withstanding change and further deterioration in economic activity. Importantly, in the current climate, this explanation should extend to the supply chain and the key relationships on which the business relies.

Experience shows that companies that report well on the issues above do so more often than not because they are well run and the information reported reflects how the business is managed. This is an important point for companies to recognise and possibly to stop and reflect on. Is the front half of the annual report a glossy marketing document with "nice stuff" or is it a document of substance that reinforces the quality of the business and its management. At times such as these the market is more challenging and inquisitive - now is the time to be transparent and to be in control of the reporting agenda.

This article appeared in the Moscow Times on 30 December 1997 and was prepared by Yulia Latynina, a staff writer for Izvestia.

©1997 Independent Press. We are grateful to the Moscow Times for granting permission for the article to be reproduced.



The Moscow Times  
30 December 1997

# Inside Russia – Imagine ‘Real’ Annual Report of a Factory

The Christmas holidays are a time for fantasizing. Lately I've been imagining, for example, how the annual report of a Russian factory would look at the end of the year, and here is what I came up with:

Dear Members of the Board of Directors!

The Severovezhsky Machine Building Factory has reached many new targets during the fiscal year.

Our debts to the federal treasury grew by 30.7 percent and came to 370 billion rubles (\$62 million). This is almost three times higher than enterprises with similar production levels, which is testimony to our good contacts with the leaders of the country.

Profits were 2.5 times lower than last year, and in the third quarter we registered net losses. Real production profitability grew, however, by 20 percent and sales volume more than doubled. Allow me to warmly congratulate our accountants and auditors.

I can't but remark on the excellent results of the closed stock company Stroinvest, the open stock company Angara and Revel Ltd., which are renting a large space from the factory. Because part of the production has been turned over to these collectives, the production costs have more than doubled. Thus, machine part No. 117P347 that is produced by our factory costs the equivalent of \$34 to make. But now that the factory is buying it from Revel, its price is \$267. I need not explain how much this benefits the factory when it comes to paying taxes.

I'd like to stress that as a result of accounting procedures between the plant and other factories producing parts, the Severovezhsky Machine Building Factory has not received a single kopek. All deliveries of production have either been

through mutual debt or barter; money went exclusively to the accounts of Stroinvest, Angara and Revel.

Nonetheless, the fiscal burden this year has been rather significant. We had to build a 12-room mansion for the nieces of the head of the regional tax police and give 12 Zhigulis, which we received by mutual debt, to the city administration. We equipped the local Interior Ministry with electronic equipment. But we should not view these outlays as simple tax deductions, but as long-term, high-return investments in the region's social infrastructure.

The biggest difficulty of the year was connected with changing banking services. As you know, the previous bank, Slava Bank, consistently held our payments without the agreement of the enterprise, and in the end we decided to turn to the services of RDDR Bank. We did so despite fierce protests from the Slava Bank management and threats from its security service, headed by the renowned authority, One-Eyed Lenka.

We can say that we rose to the occasion. First, thanks to our investment in the house of the tax police chief's nieces, the tax police fined Slava Bank 2.9 billion rubles. Second, One-Eyed Lenka was arrested thanks to the coordinated efforts of the local Interior Ministry and the RDDR Bank security service, headed by Lame Pashka.

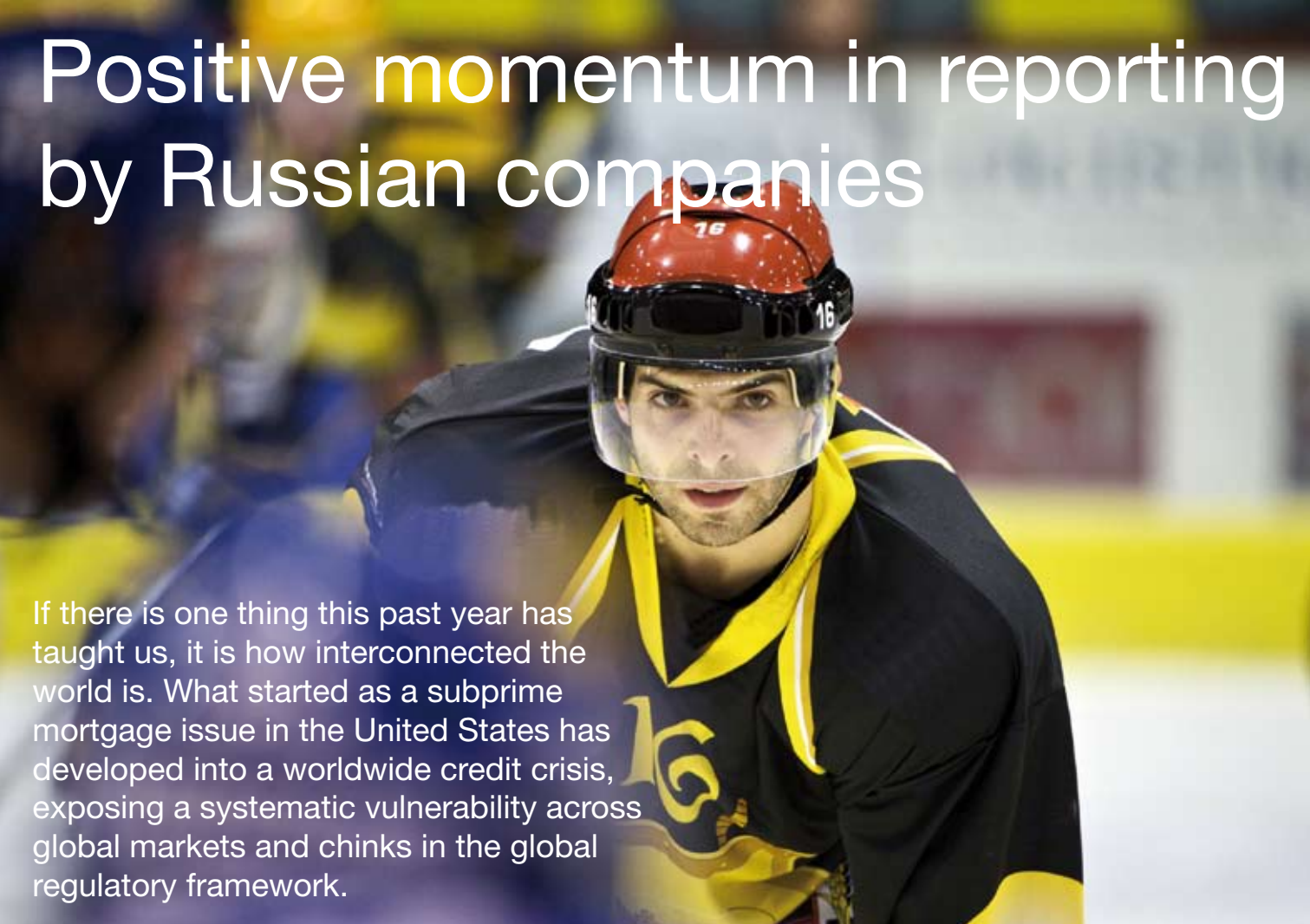
Respected members of the board! Everything I have just mentioned attests to the management's exceptional ability to orient itself in the current economic circumstances and to its clear sense of responsibility for the fate of the factory and country.

Next year we intend to incur a loss of no less than 490 billion rubles and increase our tax debt to the round sum of 800 billion rubles.

## 1997 in Russia

At the end of 1997 Boris Yeltsin was mid way through his second term as President; the country was entering a period of economic slowdown although this had not necessarily been recognised. The RTS equity index had fallen from a peak of 571 in October to 396 on 30 December, inflation was running at c.11% and short term interest rates were approximately c.15%. The government's international reserves stood at c.US\$35bn. Within a year Russia had partially defaulted on its foreign debt, the currency devalued by c.70% (against the US\$) and the equity market fell to 320.

# Positive momentum in reporting by Russian companies



If there is one thing this past year has taught us, it is how interconnected the world is. What started as a subprime mortgage issue in the United States has developed into a worldwide credit crisis, exposing a systematic vulnerability across global markets and chinks in the global regulatory framework.

After several months of seeming to be “de-coupled” from the liquidity crisis sweeping the world, the Russian economy began to feel the full impact of the crisis during the last four months of 2008 and most likely continuing for the foreseeable future. The Russian stock market has dropped by about 80% since May, many foreign investors have fled the market and, as of the end of the year, the rouble has devaluated approximately 20% since the summer. Further, some USD 400 billion in foreign debt held by Russian banks and companies becomes due for repayment in the near term. Much of the debt issued by businesses and financial institutions is dollar or euro-denominated, thus magnifying the weakness of balance sheets as the Rouble continues to soften.

Amid a slump in asset values, financial reporting and audit are becoming increasingly important. Declining commodity and share prices should give companies a reason to consider whether financial assets, inventories, long-lived assets, intangibles and goodwill have become impaired. To avoid unexpected audit results, testing for impairment in all categories of assets is a must.

Management will have to make judgements and estimates in a markedly different environment – one in which it cannot necessarily rely solely on historical assumptions. Investors will want to understand the reasonableness of and risks associated with significant judgements and estimates, and the transparency of related disclosures.

For the purposes of financial reporting under International Financial Reporting Standards (“IFRS”) and in the current economic environment, management should focus on the following issues:

- The company’s ability to continue its activities in the foreseeable future
- Impairment of long-lived assets
- Impairment of financial assets
- Compliance with long-term loan covenants for both financial and non-financial indicators
- An overview of subsequent events for the 2008 financial statements as well as interim financial reports.

This year more than ever the timeline for financial reporting will be crucial as various stakeholders including shareholders, potential investors, lenders, regulators and rating agencies are hungry for good quality financial

information so as to better understand the real financial position of a company. Over the last several years IFRS has truly become a common language for major public companies and banks in Russia. IFRS has become recognised as a form of high quality financial reporting and is widely used for management purposes by many Russian companies. Also, the quality of IFRS financial information has improved markedly over the past couple of years as people have gained ever more experience and there has been a significant knowledge transfer from the Big 4 to the management of the various companies/banks. Also, there have been improvements in areas such as audit committees, internal audit functions, and the emergence of non-executive independent directors. One of the main reasons for this is the increased interaction with the international capital markets.

The Central Bank of Russia has required banks to report in accordance with IFRS since 2004, however Russian statutory accounting is still the basis for economic (prudential) ratios and supervision. For non-banks IFRS is not mandatory by legislation, nor is there an existing mechanism for endorsement and enforcement of IFRS into the legal system. Also, some IFRS concepts/terms contradict current Russian legislation. Other impediments include the number of qualified and competent staff (unofficially there are less than 1,500 internationally qualified accountants currently in Russia) and the general unavailability of IFRS in the Russian language. However, the good news is that Accounting Reform (including IFRS) is on the Russian Government's legislative agenda for 2009 so one should assume positive changes in the medium term.

PwC Russia, as part of a consortium, sponsored by the EU TACIS Accounting Reform Project, has worked over the last couple of years with the Russian Government in trying to deal with some of the above impediments including drafting legislation for improving enforcement of accounting rules, developing drafts of revised Russian Accounting Standards ("RAS") to start bringing RAS and IFRS closer together and training hundreds of people on basic IFRS concepts. Thus, momentum towards IFRS continues.

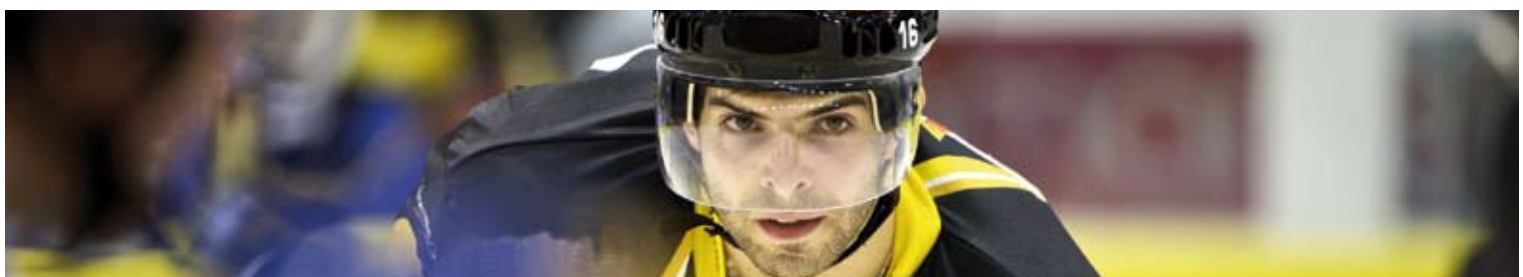
As Russian companies migrate more and more towards IFRS reporting, some of the challenges include areas around corporate governance, such as transparency, objectivity and clarity, timeliness and access, minority investor rights, etc.

One hundred pages of financial information does not mean that an entity is "transparent". In many meetings with bankers and lawyers it is clear that areas such as related party transactions and the "substance" of those dealings, and how they were reflected in the accounts, was a primary concern for potential investors. Also, "control", treatment of common control entities, the use of "proxy" companies, fair value accounting (especially for areas like fixed assets and investment property) and contingencies (particularly corporation tax) all draw lots of investor attention.

Like it or not, internal controls matter. While many Russian companies use IFRS, not many can prepare them on their own, and just hiring a couple of former Big 4 staff with IFRS experience is not the solution in itself. In general, IT platforms that allow group wide consolidations and the controllers function within Russia is generally still an immature area. Controls in this area (say the financial statement closing process) are still generally behind other parts of the world. The London Stock Exchange ("LSE") placed a very high priority in this area even before the crisis. This was brought on by the fact that more than 50% of all listed CIS companies had "material weaknesses" in internal controls. Many CIS companies will struggle, for example, to meet the new reporting requirements of the LSE, which will require equity issuers to file their audited accounts, MD&A, etc, by the end of April (i.e. within four months of year-end).

It was revealing, in many meetings with potential investors, that the inability of Management to fully explain what was in their accounts, in particular the finer points of how profits/cash flows were generated and how capital was being employed, impacted on inventors' final decisions. A finance team that does not know what is in the accounts sticks out, and is generally penalised eventually. At times financial management teams are not able to make the connection between the business and the IFRS accounts, in particular when it comes to communicating this information in documents like the MD&A included in a prospectus.

In summary, the Russian economy has made good strides toward IFRS over the past several years and, as noted above, challenges remain. However, as various GAAPs around the world head toward convergence many Russian companies are "ahead of the curve" as they have been preparing their financial statements, and in some cases management reports, under IFRS for some time.





# The fund manager's perspective

Elena Shaftan is a fund manager and Colin Croft is an analyst at Jupiter Fund Management in London. Elena manages the Jupiter Emerging European Opportunities Fund from which had assets of c. £500m at the end of September 2008, half of which is invested in Russian blue chip companies. We are grateful to Elena and Colin for providing their views.

**In a market such as Russia where there is generally less information in the public domain, how important are published financial statements? How does that differ when compared to other emerging markets?**

Published statements are important sources of information in Russia; this is clear from the market reaction when accounts are published. However, in recent months, the pace of change in the economic outlook has been such that even third quarter results have become less relevant from a valuation perspective; conditions have changed too suddenly since then for the market to attach as much importance to these numbers.

Under normal market conditions, quarterly reports have proved important for assessing the durability and progress of economic trends; over the last two years, for example, the quarterly statements of mobile phone companies have been closely followed, as investors assessed improvements in the competitive outlook: this is partly because large volumes of operational data are released along with the financial statements; this data is not available elsewhere.

The notes to the accounts and the events after the balance sheet date are particularly important. While forward-looking data is arguable more important from an investor's perspective, the notes in the published financial statements often provide a useful starting point for discussions with company management.

Much of the information in the public domain is gleaned from company statements, or from earnings conference calls.

For most Russian blue chips, the financial statements are just as important as for other emerging markets; the key difference is perhaps the relative importance of government policy in taxation and other matters; developments in this area have to be followed closely.

**How informative are the financial statements/ annual reports issued by Russian companies?**

In general they are sufficiently informative but the level of details varies. Some are very useful, such as Rosneft and Lukoil, who both provide very detailed MD&A, with a lot of operational data disclosed. Some companies are less good-for example, some companies only provide detailed COGS breakdowns in annual reports (but not in quarterly reporting).

### How would you characterise the improvement in quality of financial reporting by Russian companies over the last 10 years?

The timeliness and quality of reporting has generally improved, although progress has been faster at some companies than other. There is not a clear distinction between state-owned companies and private companies in terms of reporting quality. Some state owned companies such as Rosneft now report as rapidly as private companies, but others still produce reports with a significant lag. The frequency of reporting has also improved, with a number of companies moving to from semi-annual to quarterly reporting. However, in some isolated instances transparency has actually decreased for example, Surgutneftegas used to release detailed GAAP accounts but stopped doing this over five years ago.

### Based on the Russian companies you know/invest in, do you feel that IFRS is well embedded into financial reporting by Russian companies?

Ten years ago many Russian companies only reported to Russian accounting standards but now IFRS is common among Russian blue chips and among the London-listed smaller companies.

Among large companies, there is only one exception that continues to report only RAS numbers (Surgutneftegas), while some large companies report to US GAAP for historical reasons (they listed early, and/or listed in the US) but as these standards have converged somewhat, there is not a such a large difference from an investor's perspective.

Banks have to report in IFRS as well as in RAS, and most new listings choose to report in IFRS. Most companies that only have local listings, however, still only release RAS financials.

### As an investor, what are your three biggest concerns about the information provided by Russian companies?

The biggest concerns are:

- The historical legacy of low asset values carried on the balance sheet is an area of uncertainty; due to the large changes in asset values some companies report relatively low depreciation expenses relative to their capital expenditure. This can complicate the process of estimating how much capital expenditure is required to sustain operations and how much is required for growth. Companies can reassure investors by providing more detailed breakdowns of capital expenditures; for example, some oil companies provide geographical breakdowns which add value to the numbers, allowing investors to see the costs specific to greenfield projects.
- What is missing? When Mechel got in trouble with the government for transfer pricing, it caused their share price to plummet. But few investors would have found signs of these arrangements from reading the financial statements. Even the more transparent companies such as Lukoil sometimes produce surprises – such as the hedging losses recorded earlier in 2008; it would have been very difficult for investors to forecast

these losses from the information provided in previous statements. While the overall level of disclosure has improved in recent years, there remains a concern that important information could either be lost in aggregated numbers, or buried in the small print. Contingent liabilities (for example related to acquisitions) are not always made clear. For example, in the NLMK–John Maneely acquisition, terms to cancel the deal only became evident later. However, these concerns are just as relevant to other markets as the Enron and Parmalat scandals demonstrated.

- Lack of operational detail for some companies: the accounting numbers can only be used for financial modelling if there is enough operational data to extrapolate from. As we mentioned earlier, some companies (such as Lukoil and Rosneft) offer good levels of disclosure. However in other cases, costs are not broken down to a sufficient level of detail in the published statements, and this information has to be requested in management meetings. Moreover, in the past many companies disclosed only limited detail on the currency and maturity of debt obligations in quarterly reports. In recent months companies have started to provide more detail in response to questions from investors.

### If there were one piece of advice you would offer in this area, what is it?

Financial reporting is only one aspect of an investment decision, it is also important to engage in a recurring dialogue with management. Many Russian executives are pleasingly open and frank regarding the challenges and prospects for their companies.





# The CFO's view

Notes by Alex Bertolotti of an interview in November 2008 with Evgeny Logovinsky, the Chief Financial Officer of Sogaz, one of the largest insurance companies in Russia.

## How long has Sogaz reported under IFRS?

We have reported under IFRS for 6 years now.

## How useful do you think IFRS is for Russian insurance companies?

There are five principal reasons to produce accounts under IFRS Russian insurance companies:

- To understand the real position of the company and shareholders capital, and to gain an understanding of the value of the company
- In order to win tenders for large insurance contracts, companies need to have audited IFRS financial statements
- Thirdly, certain insurance companies require international credit ratings and IFRS financial statements are a pre-requisite
- To access the international re-insurance markets, and
- To access the international capital markets

## Do you manage your business using IFRS, Russian Statutory or other management accounts?

We have developed a strong management information system which is based primarily on IFRS. The difference between our management reports and IFRS is close to zero.

## Why is it only a small handful of Russian insurance companies report under IFRS?

Large corporates and their correspondingly large insurance contracts generally deal with the large insurance companies; hence these companies produce IFRS

financial statements. The smaller companies do not compete at this level and therefore there is no driver to produce IFRS financial statements: they do not have an international rating, do not need to access international re-insurance markets or capital markets, and they are not proposing for the large insurance contracts.

## How important are published financial statements?

No one publishes IFRS financial statements in the insurance industry; therefore they are not public knowledge. In general, the publishing or not of financial statements is therefore not so important.

## How informative are the financial statements published by Russian companies?

These are mostly based on Russian Statutory accounting, hence are produced on a more formal basis. In order to analyze this information correctly the users should keep in mind that there are significant differences between RAR and IFRS. Mostly this differences refer to consolidation, reserving and valuation procedures.

## How would you characterise the improvement in quality of financial reporting by Russian companies over the last 10 years?

Definitely there has been an improvement but it is difficult to quantify. In particular there are improvements in various areas such as the establishment of audit committees, responding to and addressing auditor management letter points and increased transparency. One of the major contributors to this is the increased interaction with the international capital markets.

# Thoughts from a Non-Executive Director

Notes by Alex Bertolotti of an interview in December 2008 with Tam Basunia, Non-Executive Director of STS-Media, a leading commercial television station in Russia which is listed on NASDAQ and Chairman of Spice Factory, a UK based film production company. Tam is a former partner in PricewaterhouseCoopers Russia B.V.

**Tam, you were in Russia for a long time, has financial reporting improved over the last 10 years in particular IFRS?**

It certainly has, for a number of important reasons. Publically quoted companies require IFRS reporting, as do bond issuers. IFRS has become tighter as well over that period in terms of the quality of the standards. Also, the general competence of finance and accounting professionals has substantially improved which has a consequent effect on the quality of financial reporting.

**Do you feel there is more transparency in public reporting of companies now compared to when you first went to Russia.**

There is indeed more transparency now compared to 10 years ago. My own company STS [for which I am a non-executive director] has recently been voted the most transparent company.

**What is the reason for this?**

Shareholders and management understand the importance of transparency and corporate governance, as it has a direct impact on their companies. If they were not transparent nor followed good corporate governance, either their cost of borrowing goes up or their share price goes down. Hence the ultimate cost of non-transparency is much greater than the implementation of a good corporate governance and reporting framework.

**Is there any further to go in terms of increased transparency?**

Yes. There has been a move but the final goal has not yet been achieved. Why is this? The reason is related party transactions. In addition, while many large companies have already implemented good corporate governance mechanisms, including independent directors and audit committees, this has not yet reached all areas of the market.



## Non Executive Director Focus

In November PricewaterhouseCoopers Non Executive Director (NED) team gathered together a small group of NED on the boards of Russian and Kazakh companies to explore some of the challenges, issues and concerns facing directors on the boards of such companies. In addition to the financial crisis topics of discussion included commodity prices, governance matters, investor communications and recruitment and retention. In 2009 we intend to hold a couple of small roundtable events for NED's involved with companies in Russia and the CIS region. For more information please contact Charles Joseland [charles.joseland@uk.pwc.com](mailto:charles.joseland@uk.pwc.com)



# Russian economic update

Over the last couple of years the Russian economy has grown at an impressive pace that in large part has been supported by booming commodity exports.

This dependence on commodity exports, which has left the country vulnerable to any falls in oil and gas prices, is currently one of the key issues faced by the Russian economy.

However, any downside risk created by falling oil prices, such as those experienced in the recent period (see Chart 1), may be of a short term nature. The demand for oil is likely to recover as the global economy picks up which could see some recovery in oil prices.

The relatively high dependence of the private sector on foreign capital has also played a key role in shaping the Russia's current economic climate. As a consequence of the global financial turmoil and uncertainties over recent political developments in the country, the Russian stock exchange has experienced an unprecedented flight of foreign capital causing the RTS index to plummet (see Chart 2).

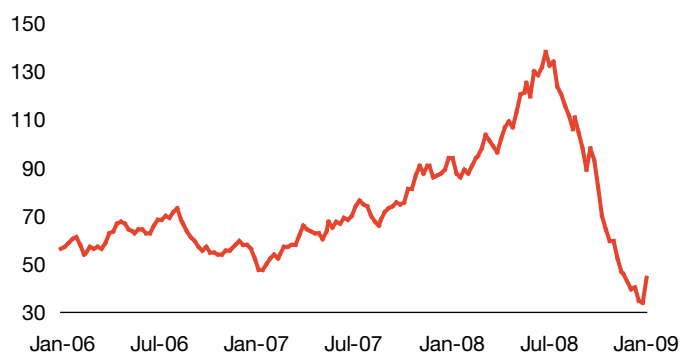
However, the impact is likely to be cushioned by the government's ability to use its significant foreign reserves partially to replace any foreign capital and meet the financing needs of domestic businesses in the short term.

The fall in oil revenues and the outflow of foreign capital have also exerted significant pressure on the value of the Russian currency (see Chart 3).

Although the economy is likely to benefit from moderate currency depreciation, the government's policy of artificially supporting the Rouble may soon prove unaffordable creating a risk of a sudden catastrophic devaluation reminiscent of the 1998 crisis.

Overall, the country's economic outlook remains cloudy and a significant slowdown is expected in the short term.

Chart 1: Oil price (US\$)



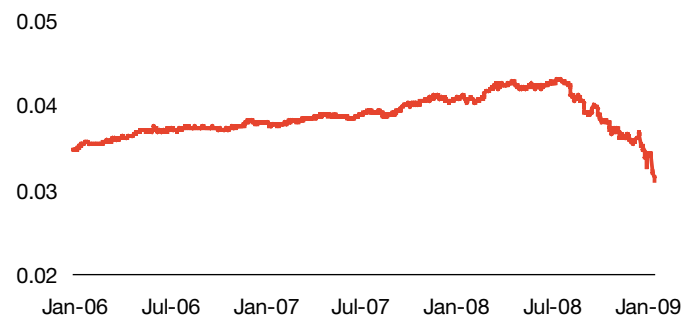
Source: Federal State Statistics Service

Chart 2: RTS stock exchange



Source: Bloomberg

Chart 3: Exchange rate (USD/RUB)



Source: Factiva

Compiled by Yael Selfin, Head of Macro Consulting,  
PricewaterhouseCoopers LLP

yael.selfin@uk.pwc.com

# Key facts and figures: Azerbaijan



|   |  |                      |
|---|--|----------------------|
| Geography                               | Azerbaijan occupies the land area of 86600 sq. km and borders with Armenia, Georgia, Iran, Russia and Turkey   |                      |
| Capital                                 | Baku   |                      |
| Population                              | 8.3 million  |                      |
| Language                                | Azerbaijani  |                      |
| Currency                                | Manat (£1 = AZN1.21 on 8 January 2009)   |                      |
| Foreign trade                           | <p>The major exportable commodities of the country are mineral products. The leading export partners are Turkey, Italy and Russia</p> <p>Important imported commodities include machines, electrical and electronic equipment. The largest imports partners are Russia, Turkey and Germany</p> |                      |
| Leading industry sectors                | Oil and natural gas extraction   |                      |
| Inbound Foreign Direct Investment (FDI) | US\$1,679 millions in 2005   |                      |
| Outbound FDI                            | US\$1,221 millions in 2005   |                      |
| Tax rates                               | Corporation Tax: 22%   | Value Added Tax: 18% |
|   | Personal income tax: varies from 14% to 35% depending on the income level  |                      |
| PwC presence                            | Active for over 13 years, with an office in Baku   |                      |
| Good to know                            | In 1879 the Nobel brothers Ludvig and Robert established their Petroleum Company in Baku. Their brother Alfred was their largest individual investor and some 12% of Nobel Prize fund was drawn from his shares in the company   |                      |

Source: PricewaterhouseCoopers (Azerbaijan), UNCTAD, Azerbaijani Embassy in the UK

For further information about doing business in Azerbaijan, please contact Nadia Blinova at the Russia & CIS Business Centre.

This section features a different CIS country each time.

Next edition: Uzbekistan



# News from the Russia & CIS Business Centre

The Russia and CIS Business Centre has been active in the last quarter and the following is a brief summary of selected activities.



Introducing

**Alex Bertolotti**

[alex.bertolotti@uk.pwc.com](mailto:alex.bertolotti@uk.pwc.com)

**Head of the Russia & CIS Business Centre**

Alex Bertolotti, a partner from PwC UK Insurance & Investment Management (I&IM) practice, has taken over as the Head of the Russia & CIS Business Centre.

Having spent the last five years of his career with PricewaterhouseCoopers Russia, Alex brings enthusiasm and relevant experience to this role. Whilst in Moscow, Alex was the leader of the PricewaterhouseCoopers I&IM practice in Russia and CIS. He specifically advised on the development of strategic plans for Russian financial institutions in the long term savings market, market entry analysis for potential foreign entrants together with the provision of other consulting and audit services to companies in the sector. Alex was Chairman of the Association of European Businesses Insurance and Pensions Committee in Russia. Under Alex's leadership PwC Russia's Insurance practice was voted by the industry for the last three consecutive years as Best Auditor and Consultant to the Russian insurance market.

In addition to the Russia & CIS Business Centre role, Alex is also an audit partner for a number of clients in the UK and will lead the Risk Assurance Services group in the I&IM sector, which includes services such as internal audit, third party assurance reports and technology assurance.

## Your Gateway to Russia & CIS Roadshows

In November and December the Russia & CIS Business Centre hosted a series of 'Your Gateway to Russia & CIS' roadshows in the firm's offices in Birmingham, Edinburgh, Manchester, and in London.

The events attracted more than 200 attendees representing businesses, private entrepreneurs, non-governmental organisations and representatives of British and Russian governments.

The seminars provided insights into doing business and investing in Russia today. The main presenters from PricewaterhouseCoopers were Ivan Berkes (Strategy, PwC UK), Martijn Peeters (Strategy Director, PwC Russia) and Svetlana Stroykova (Tax Director, PwC Russia). They were joined by export advisors Paul Corcut, Stephen Williams, Linda Smith, Paul Wilcox from UK Trade and Investment and Yuri Andreev from Scottish Development International, and Director of the Russo-British Chamber of Commerce Stephen Dalziel. The events also provided an opportunity for one-to-one discussions with Russia experts and to network.

These events demonstrated the continued interest of British businesses in Russia & the CIS region. We anticipate that roadshows will become a recurring feature of the Russia & CIS Business Centre's programme.

For more information please email [russia@uk.pwc.com](mailto:russia@uk.pwc.com) or contact:



**Nadia Blinova**

Russia & CIS Business Centre  
Executive  
PricewaterhouseCoopers LLP

020 7213 5542

[nadia.blinova@uk.pwc.com](mailto:nadia.blinova@uk.pwc.com)

# PwC Russia & CIS Business Centre

The Russia & CIS Business Centre is part of PwC UK's Emerging Markets programme; other territories/regions with dedicated Business Centres are Central & Eastern Europe, China, India and the Middle East.

The objective of the Business Centre is to be a central contact point and information source for UK clients wishing to explore business opportunities in Russia and the CIS, and for companies and individuals from the region wishing to conduct business in the UK. The Business Centre is actively involved in business networks in London and around the UK focused on Kazakhstan, Russia and Ukraine.

For more information, please email [russia@uk.pwc.com](mailto:russia@uk.pwc.com)



[pwc.co.uk/emergingmarkets](http://pwc.co.uk/emergingmarkets)

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2008 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

Design hb03951