FINANCIAL MANAGEMENT AND INSTITUTIONAL ASSESSMENT

of

JSC NC KazAvtoZhol
Republic of Kazakhstan

Prepared under TA 8888-KAZ, in support of TA 9134-KAZ Road Maintenance Sustainability Project
ABBREVIATIONS

ADB - Asian Development Bank
CfR - Committee for Roads (of MID)
EA - executing agency
FM - financial management
FMA - Financial Management Assessment
FMAQ - Financial Management Assessment Questionnaire
GDP - gross domestic product
GOK - Government of Kazakhstan
IA - implementing agency
IFI - International Financial Institution
IT - information technology
JSC - Joint Stock Company
KAD - KazAvtoDor
KARM - Kazakhstan Resident Mission (of ADB)
KAZ - Republic of Kazakhstan
KAZh - KazAvtoZhol
Km - kilometres
KZT - Tenge, the currency of Kazakhstan
LCL - local currency loan (product of ADB)
MID - Ministry of Investment & Development (KAZ)
MOF - Ministry of Finance (KAZ)
MOTC - (former) Ministry of Transport & Communications (KAZ)
O&M - operations and maintenance
NC - National Company
RAMS - road asset management system
SOE - state-owned enterprise
ROK - Republic of Kazakhstan
TA - technical assistance
TD - Treasury Department (of ADB)
YOY - year on year
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FINANCIAL MANAGEMENT ASSESSMENT

I. EXECUTIVE SUMMARY

1. This Financial Management Assessment (FMA) and Financial Analysis (FA) of JSC NC KazAvtoZhol (KAZh) has been prepared under TA 8888-KAZ\(^1\), in support of KAZ: Proposed Reconstruction of Aktobe-Kandyagash Road Projects (the Project), a loan in preparation in which the working assumptions / arrangements at the time of writing are:

   - Currency: ADB Local Currency Loan (LCL) in Tenge (KZT), the currency of Kazakhstan
   - Amount: USD 170M or equivalent
   - Executing agency: KazAvtoZhol
   - Borrower: KazAvtoZhol
   - Guarantor: Republic of Kazakhstan

2. Government of Kazakhstan (GOK) including the Ministry of Finance (MOF), the Ministry of Investment & Development (MID), and the Committee on Roads (CfR, an agency of MID), have expressed an interest that the Project be financed by ADB loans to KazAvtoZhol (KAZh) with sovereign guarantees from the Republic of Kazakhstan. This financial Management Assessment (FMA), therefore, is of KAZh as a potential borrower under this structure.

3. The assessment finds that KAZh has sufficient financial management capacity, to act as Executing Agency (IA) for the Projects, provided adequate reinforcement and capacitation is provided through Financial Management consultant.

4. This Assessment has been completed following ADB guidelines and references, particularly the relevant sections of the following: Financial Due Diligence - A Methodology Note (ADB, January 2009); Technical Guidance Note on Financial Management Assessment (ADB, March 2015); Project Financial Reporting and Auditing (ADB, 5 August 2015).

\(^1\) CAREC Corridors 1 and 6 Connector Road (Aktobe–Makat) Improvement Project
II. COUNTRY & SECTOR FINANCIAL MANAGEMENT ISSUES

1. This FMA discussed the relevant PEFA section to the project.

2. The country Public Expenditure and Financial Accountability (PEFA) performance assessment was done in 2018. The PEFA assessment shows that the Government is able to maintain aggregate fiscal discipline in difficult times, and that taxation, financial control and payment and accounting systems all work efficiently. Investment planning is under effective central direction as is demonstrated by city development and infrastructure improvements achieved since 2000.

3. Significant progress has been made in these areas since the previous PEFA assessment in 2009. Strategic planning and results-oriented budgeting have been developed, and public investment planning systematised. Financial reporting has been developed, and responsibilities for internal financial control and internal and external audit redefined in a way consistent with good international practice. The Concept “On the new budget policy of the Republic of Kazakhstan” issued by Presidential decree in 2013 set the framework for policy up to 2020, with the objectives of establishing the foundations for budget balance and budget efficiency, and then ensuring fiscal sustainability in the longer term. A number of initiatives are under way which should yield improvements.

4. The introduction for the first time in 2017 of internal audit throughout Government as a service to management, directed in accordance with good international practice at improvement of systems for service delivery, should contribute to better performance by Ministries in the execution of their functions. The process under way of moving progressively to consolidated Government financial reporting on an accruals basis offers the opportunity to improve the transparency and accountability of government operations, provided that the consolidation of the different elements – central and subnational governments, RSEs and State-Owned Enterprises is transparently presented.

5. Policy-based fiscal strategy and budgeting. Macroeconomic and fiscal forecasting is reasonably good. The Ministry of National Economy prepares a Social and Economic Development Forecast for five years which is approved by Government and submitted to Parliament together with the draft budget. The Plans include macro-economic and aggregate fiscal forecasts for three years ahead, and are updated during the year.

6. Predictability and control in budget execution. Predictability of in-year resource allocation, all Republic Budget (RB) cash balances, are consolidated daily in the Treasury Single Account. The cash forecasting and monitoring systems work well. A cash flow plan is prepared at the beginning of the year setting out monthly allocations to each ministry and agency, and thereafter updated monthly. Spending ministries have assurance that funds will be provided according to annual financial forecast approved by the Treasury Committee. They are also fully confident that cash will be available to meet commitments when they become due. In-year budget adjustments were limited to twice a year in accordance with the Budget Code.

7. Internal controls on non-salary expenditure. There are extensive internal controls on non-payroll expenditure established by the regulatory framework. Commitment controls operate through the E-MINFIN automated Treasury system, ensuring that payments cannot be executed without a budgetary allocation and available cash. There is clear
separation of duties. Compliance with payment rules and procedures is high. The high effectiveness on these dimensions leads to an overall indicator score of A.

8. **Internal audit** is at an early stage of development in Kazakhstan having only been established (as opposed to financial control and inspection) in 2017, but it is operational across Government. Internal audit is risk-based and takes the form of compliance, systems and performance audit. Audit plans are largely adhered to and regular reports are submitted to management though it is too early to judge the response. Overall indicator score: B+.

9. **Accounting and reporting.** In terms of financial data integrity, bank account reconciliations and clearance of suspense and advances accounts for Budgetary Central Government are generally prompt and up to date. High standards are applied to the maintenance of financial records with a clear audit trail; independent assessments by National Bank of the Republic of Kazakhstan (NBRK) have indicated satisfaction with the integrity of financial systems and records. Overall indicator score: B+.

10. The annual financial statements produced by each Ministry contain information on revenue, expenditure, financial assets and short and long-term liabilities, and a cash flow statement. The Government’s budget execution statement was submitted to the Accounts Committee (AC) for audit less than three months after the year end. Ministry financial statements have been produced on a modified accruals basis in line with IPSAS, although a consolidated statement for the RB has not yet been published. A process of implementing accounting standards based on IPSAS is under way and a complete consolidated Government financial position statement is planned for 2020 (in respect of 2019).

11. **External scrutiny and audit.** External audit is the responsibility of the AC and scores well. Audits were directed at efficiency of spending as well as compliance with laws, and included reviews of Ministries’ annual financial statements when they were subject to audit. Audits were conducted in accordance with INTOSAI standards. Audit reports on budget execution are submitted to parliament within 5 months of the year end and recommendations are acted upon. Legislative scrutiny of external audit reports is thorough and timely. Scrutiny is transparent and AC recommendations form the basis of Parliament’s recommendations to Government which are published on the parliamentary website. Some public hearings are held with Ministries. Overall indicator score: B+.

12. **Effective of internal control framework.** The internal control framework in Kazakhstan is well-regulated in terms of Laws, Concepts, Orders and Decrees. The 2015 Law on State Audit has clarified the respective responsibilities of the Accounts Committee, State Committee on Internal Public Audit and ministerial internal audit departments. Traditionally great emphasis has been placed on financial control and inspection which has lacked the added value which true internal audit can bring to management effectiveness. Genuine internal audit is still at an early stage of development but it is encouraging to report that it is now operational in most government agencies, especially in those which incur large amounts of public spending. The State Committee plays a number of important roles in internal control including the setting of control standards and the evaluation of the effectiveness of internal audit services. Each Government agency is responsible for its internal financial control system, which should cover the successive stages of control – approval, authorization and execution – of each transaction. Regulations on the control
environment require different individuals to approve contracts, authorize commitments and execute payments.

13. Under PEFA assessment, the control environment is one where strong hierarchical supervision is emphasized. Risk assessment systems are used as a basis for audit planning in relation to both expenditure and revenues, especially tax revenues, and debt management is focused on tight control over total external debt. The internal control framework is reasonably effective and should become stronger as internal audit practice develops.

14. Approach to public financial management reforms Kazakhstan seeks to match the performance of OECD countries in PFM as part of its overall ambition to become one of the 30 most developed countries in the world by 2050. As a country with substantial hydrocarbon and other mineral resources, which in most years has generated fiscal and current balance of payments surpluses, it has been little dependent on foreign assistance in its efforts to develop PFM systems which match its ambitions. There has been no question of a PFM reform programme being developed as a condition of the receipt of assistance from IMF, EU, WB or other external sources. Kazakhstan has developed its own PFM structures and management systems, based to a considerable extent on reproducing the practices of the global corporate sector.

15. Recent and ongoing reform actions. In addition to adjustments to the Budget Code, a new law was enacted on State Audit and Financial Control (November 2015) and a new Tax Code in December 2017. The supervision of financial control throughout Government is assigned to the State Committee on Internal Public Audit under MoF, which also coordinates the work of internal audit departments in each Ministry and undertakes much of the financial audit work on government accounts. Internal audit as a service to management in each Ministry has now been operative throughout the Government since January 2017, and should progressively improve each Ministry’s performance of its tasks. Oversight and coordination of internal and external audit work is assigned to the AC which, as Kazakhstan’s Supreme Audit Institution (SAI), serves as the Central Government’s external auditor, and the manager of the database of all audit findings by auditors of central and subnational government. The AC is also responsible for the training and qualification of auditors working in the public sector.

16. Work is in progress to produce an accruals-based budget execution statement for the RB for the year 2018, and a consolidated statement of the Government’s financial position for 2019. This is already an ambitious project which should pave the way for the eventual production of IPSAS-conforming financial statements for the public sector as a whole. It will be important at each stage of this work to provide clear explanations of the methods of consolidation and the advantages – not least in attracting inward investment - of giving a complete account of all the Government’s assets and liabilities.

III. GOK INSTITUTIONAL STRUCTURE FOR ROADS SECTOR GOVERNANCE

17. For a long period in Kazakhstan, there has been a gradual evolution of the roles played by the various ministries and agencies in relation to property, management and implementation of work in the road sector. The road sector of Kazakhstan at the republican level is under the jurisdiction of the Ministry of Investment and Development (MID), which is responsible for national roads of national importance through the Committee for Roads (CfR). Operational management and control over road works on
the roads of national importance was transferred to JSC NC KazAvtoZhol (KAZh), which acts as the manager of the road network (the national operator). KAZh is responsible for purchasing and executing the functions of the Employer on behalf of the Government. Road works include the construction and reconstruction according to the development budget and current budget, overhaul, medium and current repair and maintenance (summer and winter). KAZh determines Contractors for all works through open tenders, with the exception of road maintenance (summer and winter), where the Contractor is RSE "KazakhAvtoDor"; and the maintenance of toll roads, which KAZh carries out through its branch of the "Toll road directorate". At the same time, in the framework of loans under the state guarantee between KAZh and the International Financial Institutions (EBRD, Export-Import Bank of China), KAZh already carries out works without the participation of the CfR. At the same time, if we consider the current situation of institutional management of the road sector (see Figure 1), now there are 3 Employers for the construction of roads of national importance:

a) CfR for projects financed under government loans;
b) KAZh for projects financed under the state budget;
c) KAZh for projects financed under borrowed funds on state guarantee.

A. Ministry of Investment and Development

18. The Ministry of Investment and Development (MID) was established in 2014 as the legal successor of the Ministry of Transport and Communications (MoTC), with the transfer of functions and powers of several other state bodies. MID is responsible for improving the regulatory framework of the road sector and manages the roads of international and national importance. According to the organizational structure of the MID (see Figure 2), the Ministry includes 26 structural units, including: Committees - 8; Departments - 18. Total personnel = 2,202, comprising: 324 in the Central Office, 618 in various committees (including CfR), and 1,260 in various oblast-level branches.
Figure 1 – Current institutional arrangements for implementation of national-level road works

Ministry of Investment and Development (MID)

Committee for Roads MID of RoK (CfR)

State building contract: for construction and maintenance separately (annual agreement)

JSC «NC «Kazakhstan Temir zholy»

JSC «NC «KazAutoZhol» (KAZh)
14 branches

KAZh loan on a state guarantee
(EBRD, Exim Bank of China)

Directorate under construction (KAZh)

Service providers for the development of a feasibility study

RSE «Obzholaboratoriya»

Direct financing

Market environment

Service providers for road diagnostics and improvement of regulatory and technical documentation

Service providers for the development of design estimates

Contractors for the construction, reconstruction and repair of roads

Conclusion of Contract from one source (direct implementation)

RSE "Kazahavtodor" is a single provider of services for the maintenance of the republican roads

Conclusion of Contract from one source (direct implementation)

Direction of toll roads

Appointed Contractors

Contractors for the construction and reconstruction of roads (turn-key projects)
Financial Management & Institutional Assessment of JSC NC KazAvtoZhol

Figure 2 – Organizational chart of MID

MINISTER

Department of Investigation of Transport Accidents and Incidents (10)

Department of Internal Audit (9)

Department for the Protection of State Secrets, Information Security and Mobilization Training (11)

Committee for Industrial Development and Industrial Safety (534)

Committee of Geology and Subsoil management (119)

Commissioner for Ethics (1)

Committee for Construction and Housing and Communal Services (124)

Committee on Investments (55)

Subsoil management Department (21)

Department of Strategic Planning (28)

Department for Civil aviation (75)

Asset Management Department (14)

Subsoil management Department (21)

Finance Department (29)

Department for Roads (60)

Department for foreign economic cooperation (22)

Department of Technological and Innovative Development (16)

Legal Department (25)

Department of Economic Integration (13)

Department of Development of construction industry and housing and communal services (11)

Department for Export Development and Promotion (9)

Transport Committee (636)

Department of Development of Construction industry and housing and communal services (11)

Note:
Number of staff of MID – 2202, including: Central office – 324, Committees – 618; territorial divisions – 1260. Structural divisions of MID – 26, including: Committees – 8; Departments – 18.
B. Committee for Roads

19. Under MID, the road sector is managed by the Committee for Roads (CfR), a republican state institution and the administrator of the MID budget programs on Roads. CfR is financed from the republican budget and is responsible for managing roads of international and national importance. The CfR is responsible for implementing state policy, developing and harmonizing the regulatory and technical base, including ensuring compliance with them, investment and social policies, financing of the national operator (KAZh), organizing work quality control, and introducing and operating of toll roads. CfR also transfers to the regional budgets and the cities of Astana and Almaty for the development and repair of local roads. CfR has 60 employees (excluding employees of subordinate organizations, such as JSC KazdorNII, RSE KazakhAvtoDor and RSI Oblzhollaboratoriya). The employees of CfR are divided into 9 boards.

Figure 3 – Organizational structure of the Committee for Roads

Note: Number of staff – 60 units

20. Note re RSE Oblzhollaboratoriya: The CfR had its own territorial divisions in each of the 14 oblasts, but in 2013 they were transferred to the JSC NC KazAvtoZhol. Therefore, at the regional level, the CfR has only 16 RSI "Oblzhollaboratoriya". These were established in 2005 in accordance with Government Decree No. 1305, which are responsible for quality control of road works and construction materials under national roads, as well as on projects implemented on regional and district roads financed by targeted transfers from the Republican Budget. Each RSI "Oblzhollaboratoriya" has an average of 17 employees, of which approximately half occupy management and engineering positions (including materials engineer, 2 quality engineers and 3 assistants of engineer). The RSI "Oblzhollaboratoriya" conducts tests of materials, and also performs selective examination of the quality of road works using instrumental methods of control. At the same time, the RSI officially confirms the work performed before the CfR makes payment to KAZh. The Ministry completed in 2017 the equipment of the RSI "Oblzhollaboratoriya" with 16 multifunctional mobile road laboratories. At present, it is planned to establish a republican state enterprise "National Center for the Quality of Road Assets" (Center), the creation of which is planned by reorganizing 16 RSI

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2 This organization is not treated in detail in this Assessment as it is not relevant to FM of KAZh.
“Oblzhollaboratoriya” in 1 Center. At the same time, the functions of the Center under Road Management will be expanded, including:

a) Expansion of the expertise of the quality of works and materials from national roads (24.0 thousand km) to local roads (70 thousand km) and streets of populated areas (72.5 thousand km).

b) Administration and management of the road database, including diagnostics and certification work;

c) Administering the system for the introduction of new technologies and materials;

d) Monitoring of road safety;

e) Conducting mobilization training

f) Carrying out of departmental reviews / studies (“expertise”) for technical documentation on medium repair.

Figure 4 – Proposed Organization of new unitary Center

C. RSE KazakhAvtoDor

21. Republican state enterprise KazAvtoDor (KAD) was created by the Government Decree No. 1266 in 1998, as responsible for the management of highways of international republican importance. The RSE has its own bank account and balance. In accordance with the charter, the purpose of the RSE is to carry out current repair works, maintenance and planting of public roads.

22. By Decree No. 1527 of 2000, the RSE was defined as a single Contractor for the production of works for the maintenance, planting and current repair of public roads of national importance. Thus, the RSE fulfills the role of the Contractor in the maintenance of roads. The RSE has 14 branches in each region, 79 road maintenance sections, 179 road maintenance points and 7 forest plantations, 2,724 units of road construction equipment, and a staff of 3,408 persons, about half of which are directly involved in the maintenance of roads.
23. Currently, the RSE according to the comprehensive privatization plan for 2016-2020, approved by Decree No. 1141 of the Government of the Republic of Kazakhstan dated December 30, 2015, is on the list of priority state companies subject to privatization. For what purpose in 2017, the RSE has been transformed into 14 LLPs. Preliminarily, the completion date for the privatization process was February-March 2018, but at the current stage is not continued, due to the need for a political decision.

D. JSC NC KazAvtoZhol

24. Joint Stock Company National Company KazAvtoZhol was established by Government Decree No. 79 in 2013 as a national operator for all roads of national importance. JSC NC KazAvtoZhol is responsible for procurement and supervision of construction, reconstruction and repair (capital, medium and current), and also acts as the manager of the national road network. Contractors for all types of work are determined through open tenders in accordance with the Procurement Rules of JSC NC "KazAvtoZhol" approved by the decision of the Board of Directors dated September 30, 2013 No. 6, except for the maintenance of roads where the contractor is designated RSE "KazakhAvtoDor". Works under maintenance of toll roads are carried out by JSC NC "KazAvtoZhol" independently.

25. JSC NC KazAvtoZhol is also responsible for the management of toll roads, including charges for tolling and their maintenance. At present, for operating 211 km of toll road JSC NC KazAvtoZhol" accepted RMS and RMP that it received from RSE "KazakhAvtoDor", which are now organized in the directorates of toll roads, which carries out maintenance of the roads at the expense of income from tolling.

26. In January 2015, KAZh shares were transferred to JSC NC Kazakhstan Temir Zholy ", which, in turn, is a subsidiary of the joint-stock company" National Welfare Fund "Samruk-Kazyna".

27. KAZh until December 2018 had 673 employees, most of whom are located in regional branches (303 employees) and in the Directorate of Toll Roads (261 employees). By the decision of the Board of Directors of KAZh, by Protocol No. 45/17 dated December 21, 2017, the staff number increased to 956 units (see Figure 5).

28. Also in August 2017, the "Directorate for Construction" was established under KAZh, responsible for management of investment projects implemented at the expense of the EBRD and the Export-Import Bank of China (see Figure 6).

29. Within the framework of the national Digital Kazakhstan state program, KAZh plans to create a separate IT Directorate.
Figure 5 – Organization of KAZh

The number of staff - 956 units
IV. FINANCIAL MANAGEMENT ASSESSMENT

A. Strengths & Weaknesses

30. At present, this assessment indicates that KAZh has a good automated accounting system (which is common to, and integrated across, almost all GOK units), has experienced and well-trained accounting and FM staff working in a finance organization with low turnover and good adherence to policies and procedures, and is adequately audited within GOK mechanisms by two ministries’ internal audit units. With appropriate capacitation and FM consultants support, therefore, it could function as an EA for the Project.

31. However, KAZh has no experience in implementing ADB-funded projects. For this reason, this assessment concludes that a reasonable project FM system would incorporate a dedicated FM consultant. This should be physically situated within the KAZh HQ building and have complete access at all times to its KAZh finance staff, to work closely and familiarize them with ADB procedures, systems, paperwork, etc. related to loan administration and project FM. FM consultant will also provide knowledge transferred to KAZh finance staff to familiarize ADB procedures.

B. Personnel, accounting policies and procedures, internal control, internal and external audit

32. Current and Proposed FM Personnel. The assessment has examined KAZh’s current staffing of its financial and accounting units. Finance and Accounting staff are experienced and qualified in their fields. Although they have experiences with other IFI's project, they do not have experience with ADB-funded project. It recommends that one qualified and ADB-experienced bilingual (Russian-English) consultant be recruited to work closely with KAZh's Finance section and to assist in training and supporting KAZh permanent staff in the administration and implementation of ADB loan-financed projects.

33. Accounting Policies and Procedures. There are accounting policies and procedure in place and implemented in the KAZh. This assessment concludes that the existing accounting policies and procedures of KAZh are adequate, but that ADB should ensure that any FM consultant for an ADB project is well-versed in ADB loan administration and project implementation procedures.

34. Internal Audit. KAZh has an internal audit function which reports to the General Director. It files annual accounts with MOF, which are subject to further internal GOK audit, first, by the MID / CfR Department of Internal Audit and Financial Control, and, second, by the MOF Internal State Audit Committee. Financial statements are lodged with the MOF’s Depositary or Financial Objects (DFO), where they are publicly available. Adequate internal control in place and followed by staff. No major weakness identified.

Figure 1 – Hierarchy of Internal Audit Functions – GOK
35. **External Audit.** KAZh accounts is audited by independent auditor. Since the establishment in 2013 to 2017, Deloitte was appointed for 2013 and 2014 and KPMG was appointed for 2015 to 2017. KAZh received unqualified opinions.
Table 5: Proposed Audit Report & Timing

<table>
<thead>
<tr>
<th>Proposed Audit Report</th>
<th>Proposed Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Financial Statements for the Project for the year ended December 31st and Independent Auditors' Report</td>
<td>No later than 30 June of the following year.</td>
</tr>
<tr>
<td>Annual Financial Statements for KAzh and Independent Auditors' Report</td>
<td>Within one month after the approval of KAzh’s relevant authority</td>
</tr>
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</table>

C. **Financial reporting systems, including use of information technology**

36. The FM and accounting system currently used by KAZh is a Russian commercial cloud-based enterprise-scale IFRS-compliant platform called "1-C Accounting for State Institutions of Kazakhstan", based on a widely-used Russian accounting system and customized for use by GOK. It has been used by GOK, through various versions (currently v8.x), since 2010.

37. The 1-C system reflects IFRS-standard GOK accounting rules, and is periodically updated following any changes from MOF or other regulators to accounting practices or formats. The system uses the GOK chart of accounts approved by the MOF Treasury Department\(^3\) order (dated January 27, 1998 No. 30 (as amended and supplemented on May 25, 1999, No. 238 and February 18, 2002 No. 67).

38. Among other functions such as taxes and pensions, not relevant to the FMA, the system covers all enterprise accounting and financial reporting requirements of KAZh and other GOK units.

39. The assessment finds that this accounting system provides a solid foundation for KAZh (and other GOK NCs) for all aspects of FM.

D. **Proposed overall loan structure and funds flow**

40. The diagram below illustrates the funds flow for a subsovereign loan to KAZh, with supporting sovereign guarantee of Republic of Kazakhstan.

41. The loan will be in local currency Tenge. A minimum withdrawal application is $20 million equivalent in Tenge. Advance fund procedure will be used in this project. Although KAZh finance and accounting staff are experiences with other development partners’ projects (such as EBRD and Export and Import Bank of China) and internal control in place (such as opening and managing bank account of foreign investment projects guaranteed by the government is approved and monitored by MOF), managing a large advance fund is considered substantial risk. To mitigate the risk, it is recommended the following

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(i) KAZh open a separate bank account for the project in a good credit rating bank in Kazakhstan
(ii) KAZh will liquidate the advance account monthly
(iii) ADB conduct Statements of Expenditure annually
(iv) ADB and KAZh will reassess the staff resource annual to ensure adequate staff to manage the fund

Figure 2: Proposed Funds Flow

V. RISKS DESCRIPTIONS AND RATINGS

42. This assessment of KAZh's FM systems, policies, procedures and overall capacity has resulted in the following general risk scorings and suggestions for mitigation measures.

43. The overall risk rating is substantial due to large advance fund procedure for local currency loan is used for the project with limited good credit banks in the country.

<table>
<thead>
<tr>
<th>Inherent Risks</th>
<th>Risk assessment*</th>
<th>Risk descriptions</th>
<th>Risk mitigation measures</th>
</tr>
</thead>
</table>

Source: IFCL
### 1. Country-Specific Risks

| M | Execution risk - Interest rate fluctuation for local currency loan (if floating rate selected) |
| Government has requested a local currency loan (LCL), interest rate of LCL may be fluctuated over the implementation period. Suggest KaZh, CfR, MID closely monitor implementation and disbursement schedule. |

### 2. Entity-Specific Risks

| M | Compliance risk - Audit requirements are not fully complied with, due to KaZh’s staff have limited understanding of ADB requirements |
| Training on ADB’s financial management requirements for Finance unit in KazhAvtoZhol. Financial consultant will be hired to assist KaZh familiarize with ADB’s requirements. Recruit external auditor of project accounts |

| S | Execution risk – inexperience to manage large advance fund procedure and limited good credit rating bank in the country |
| Open advance account in a good credit rating bank |
| Provide ADB monthly liquidation |
| Conduct SOE review by ADB annually |
| Reassess staff resource to ensure adequate staff to manage advance fund |

### Overall Inherent Risk

<p>| S | |</p>
<table>
<thead>
<tr>
<th>Control Risks</th>
<th>Risk Assessment*</th>
<th>Risk description</th>
<th>Risk Mitigation measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Implementing Entity / Borrower (KAZh)</td>
<td>M</td>
<td>Compliance risk - Audit requirements are not fully complied with, due to KaZh’s staff have limited understanding of ADB requirements</td>
<td>Open advance account in a good credit rating bank. Provide ADB monthly liquidation. Conduct SOE review by ADB annually. Reassess staff resource to ensure adequate staff to manage advance fund.</td>
</tr>
<tr>
<td>2. Funds Flow</td>
<td>S</td>
<td>Execution risk – inexperience to manage large advance fund procedure and limited good credit rating bank in the country</td>
<td>Subsovereign LCL loan to KAZh in KZT (USD160M equivalent), wherever possible into segregated project accounts using tight controls or a trustee if possible, and with ADB direct procurement &amp; disbursement wherever possible.</td>
</tr>
<tr>
<td>3. Staffing</td>
<td>M</td>
<td>Compliance risk - Audit requirements are not fully complied with, due to KaZh’s staff have limited understanding of ADB requirements</td>
<td>Training on ADB’s financial management requirements for the Finance Unit in KazhAvtoZhol. Financial consultant will be hired to assist KaZh familiarize with ADB’s requirements. Recruit external auditor for project accounts.</td>
</tr>
<tr>
<td>4. Accounting Policies and Procedures</td>
<td>L</td>
<td></td>
<td>Include the project in KaZh and MID’s internal audit plan.</td>
</tr>
<tr>
<td>5. Internal Audit</td>
<td>L</td>
<td></td>
<td>Include the project in KaZh and MID’s internal audit plan.</td>
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### VI. FINANCIAL MANAGEMENT ACTION PLAN

<table>
<thead>
<tr>
<th>Action</th>
<th>Responsibility</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recruit FM consultant with ADB-funded project experiences</td>
<td>KaZh</td>
<td>After loan effectiveness</td>
</tr>
<tr>
<td>Open bank account for advance fund with a good credit rating bank</td>
<td>KaZh</td>
<td>After loan effectiveness</td>
</tr>
<tr>
<td>Submit monthly liquidation of advance fund to ADB</td>
<td>KaZh</td>
<td>Monthly during project implementation</td>
</tr>
<tr>
<td>Perform financial management assessment</td>
<td>ADB</td>
<td>Annually during project implementation</td>
</tr>
<tr>
<td>Reassess accounting staff resource to ensure adequate resource to manage advance fund</td>
<td>KaZh and ADB</td>
<td>Annually</td>
</tr>
<tr>
<td>Submit audited project financial statements</td>
<td>KaZh</td>
<td>Annually and within 6 months after financial year end</td>
</tr>
<tr>
<td>Submit audited financial statements of Kazhavtozhol</td>
<td>KaZh</td>
<td>Annually and within 1 month after KaZh’s relevant authority approval</td>
</tr>
</tbody>
</table>

Overall Control Risk: M

Overall risk: S

*H = High, S = Substantial, M = Moderate, N = Negligible or Low.*
| Using relevant accounting software for the project | KaZh | Within 6 months after effectiveness |
VI. FINANCIAL ANALYSIS OF KAZHAVTOZHOL

KAZAVTOZHOL’S FINANCIAL PERFORMANCE

A. KazAvtoZhols’s structure and activities

44. KAZh was created in March 2013 as a Joint Stock Company (the “Company”) with Ministry of Industry and Infrastructure Development (MIID) of Republic of Kazakhstan as the sole shareholder. The shareholding of Company’s by the Government is represented by the Committee on State Property and Privatisation of the Ministry of Finance. Kazakhstan Temir Zholy (KTZ) provides management support to KAZh in terms of strategy support, systems and key personnel. In July 2013, the Company was given the status of a ‘National Company’. The Company’s main activities include planning, construction, operation and maintenance of international and national highways within the framework of state programs and trust management agreements. KAZh is a national road operator.

45. The legal status of KAZh, as a National Company, allows it to implement projects for construction, reconstruction, repair and maintenance of roads, and it is able to attract and use all sources of funding not prohibited by the legislation of the Republic of Kazakhstan. In accordance with the charter of the Company, the Companies main activities are to:

a. Implement budget investment projects to develop international and national highway networks, based on state requirements;

b. Plan, construct, reconstruct, repair and maintain international and national highways within the framework of state programs;

c. Control and manage the quality of construction, reconstruction, repair and maintenance of international and national highways of public use within the framework of state programs;

d. Make repairs where defects areas hindering the uninterrupted and safe passage of vehicles on toll roads;

e. Collect toll on toll roads; and

f. Undertake other activities not prohibited by law of the Republic of Kazakhstan.

46. KAZh get reimbursement of the expenses based on trust management agreement with MIID from MoF on monthly and annual basis based on the requests agreed and approved by MIID and MoF according to the scheme below:

a. To receive budget funds for servicing the loan, the Company sends a budget request to the MIID of the RK, then sends the MIID of the RK to the Ministry of Finance of the RK, where it is approved. The DDU is signed from three sides - KAZH, KAD MIIR RK and KGIP MF RK, according to the DDU reimburses all expenses with the improvement of this facility.
b. The scheme is signed by the DDU, under the budget program 233 “Fulfillment of obligations under a trust management agreement” all expenses are charged according to the budget request and according to the approved budget for a certain year, the Company signs an act on compensation from CAD MIID RK on a monthly basis, then the Company pays for counterparties and the Bank (loan servicing and repayment of principal).

c. For servicing non-state loans under the state guarantee, a budget program 233 “Fulfillment of obligations under a trust management contract” has been created. To implement the loan repayment mechanism in the framework of the DDU, changes were made to the Budget Code of the Republic of Kazakhstan, the Rules on Approving the Rules for Transferring State Property to Trust Management - Order of the Minister of National Economy No. 17, and Rules No. 540 on Approving the Rules for Execution of the Budget and Its Cash Services. - Order of the Minister of Finance of the Republic of Kazakhstan.

B. Historical financial performance

<table>
<thead>
<tr>
<th>000 KZT</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>145,415,347</td>
<td>214,459,088</td>
<td>187,196,327</td>
<td>183,910,840</td>
<td>222,896,037</td>
</tr>
<tr>
<td>COGS</td>
<td>144,389,458</td>
<td>213,383,311</td>
<td>186,400,305</td>
<td>183,298,191</td>
<td>220,675,106</td>
</tr>
<tr>
<td>Admin Expenses</td>
<td>1,041,549</td>
<td>1,298,111</td>
<td>1,165,860</td>
<td>993,039</td>
<td>2,597,927</td>
</tr>
<tr>
<td>Other expenses</td>
<td>0</td>
<td>0</td>
<td>9,002</td>
<td>2,563,966</td>
<td>63,325,238</td>
</tr>
<tr>
<td>Other income</td>
<td>15,660</td>
<td>229,363</td>
<td>303,774</td>
<td>947,075</td>
<td>15,806,119</td>
</tr>
<tr>
<td>(Loss)/Profit Before tax</td>
<td>0</td>
<td>33,289</td>
<td>(75,066)</td>
<td>509,938</td>
<td>(46,768,252)</td>
</tr>
<tr>
<td>Income tax</td>
<td>79,199</td>
<td>41,154</td>
<td>7,454</td>
<td>476,995</td>
<td>173,755</td>
</tr>
<tr>
<td>(Loss)/Profit for the year</td>
<td>(79,199)</td>
<td>(7,865)</td>
<td>(82,520)</td>
<td>32,943</td>
<td>(46,942,007)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
</tr>
<tr>
<td>Non-current assets</td>
</tr>
<tr>
<td>Total assets</td>
</tr>
<tr>
<td>Current liabilities</td>
</tr>
<tr>
<td>Non-current liabilities</td>
</tr>
<tr>
<td>Total liabilities</td>
</tr>
<tr>
<td>Total Equity</td>
</tr>
</tbody>
</table>

47. KAZh is relatively a new company. Since they function as an operator, their costs included investment cost (interest and principal) are covered under trust management agreement and state programs. The funds go through P&L as their revenue.

48. The financial statements indicate the following key information:

a. The company has limited track record since its inception but has been growing significantly since establishment in 2013 in term of assets (over 14 times increase in 2018) and liabilities (over 17 times increase in 2018).

b. The source of revenue is service fees to implement the annual trust management contracts and state programs.

c. In 2018 of unaudited financial statements, the company incurred $118 million loss due to the accounting treatment of revaluation of its foreign currency long-term loan obligations which are primarily denominated in US$. While this impacts on the
company’s equity, the negative equity will be improved when the company receives the funds to repay the loan (i.e. interest and principal) after the grace period.

d. The company has recently borrowed from EBRD $189M in 2016; and Exim Bank of China $1.7 billion in 2017 and additional $2.4 billion in 2018.

C. Financial projection

49. KazAvtoZhol is considered as a road operator which revenue is based on the service fee from contract agreements. The projections show that KazAvtoZhol is financially sustainable because the company get reimbursement of the expenses for its operations and debt services based on state programs and trust management agreements from Ministry of Finance (MoF) on monthly and annual basis according to the agreements.

Revenue:

50. **Toll roads.** A conservative assumption of 7,000 km roads is tolled which is only about 60% of KazAvtoZhol’s development plan by 2022 (to reach 12,000 km). Toll fee is assumed as the current fee of 2.6 KZT per km per vehicle with indexation using CPI Kazakhstan. Traffic volume under ADB’s project is based on TRTA consultant. The traffic volume under EBRD and Exim Bank of China is based on KazAvtoZhol’s data.

51. **Contract management activities.** Revenue divided for 3 main activities from Program 003; Program 091; and Program 233 and based on KazAvtoZhol’s development plan until 2022. After that, revenue is indexed based on CPI Kazakhstan rate

52. **Debt compensation.** Comprises from interest and principal repayment from loans taken from EBRD, EXIM and ADB. Repayment of principal for EBRD starts from year 2021; for EXIM from 2022 and for ADB from 2025. Debt Compensation estimated as total debt and interest payment less gross profit gained from toll roads. Therefore, remainder of uncovered debt (if any) will be compensated by government.

Cost of Goods Sold (COGS):

53. **COGS for management activities.** It is taken from KazAvtoZhol's development plan until 2022 and then indexed based on CPI Kazakhstan. Operations and maintenance for new toll roads (under ADB, EBRD, Exim Bank of China) is assumed at $4,803 per km a year in 2018 for routine and periodic maintenance. It is a moderate assumption for newly reconstruction road. Further indexed for CPI KZ and multiple per km under operation for toll roads for the subsequent years.
### Balance sheet

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
<th>2029</th>
<th>2030</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other expenses</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other income</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(Loss)/Profit before tax</td>
<td>(8,844)</td>
<td>(7,839,829)</td>
<td>(10,461,600)</td>
<td>(3,295,952)</td>
<td>40,262,889</td>
<td>32,920,256</td>
<td>203,277,594</td>
<td>196,563,262</td>
<td>212,211,061</td>
<td>222,292,147</td>
<td>231,960,691</td>
<td>240,614,197</td>
</tr>
<tr>
<td>Income tax</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(Loss)/Profit for the year</td>
<td>(8,844)</td>
<td>(7,839,829)</td>
<td>(10,461,600)</td>
<td>(3,295,952)</td>
<td>40,262,889</td>
<td>32,920,256</td>
<td>203,277,594</td>
<td>196,563,262</td>
<td>212,211,061</td>
<td>222,292,147</td>
<td>231,960,691</td>
<td>240,614,197</td>
</tr>
</tbody>
</table>

### Operating indicators

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
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<th>2026</th>
<th>2027</th>
<th>2028</th>
<th>2029</th>
<th>2030</th>
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</thead>
<tbody>
<tr>
<td>Operating ratio</td>
<td>0.97x</td>
<td>1.00x</td>
<td>1.00x</td>
<td>0.90x</td>
<td>0.74x</td>
<td>0.74x</td>
<td>0.52x</td>
<td>0.54x</td>
<td>0.53x</td>
<td>0.53x</td>
<td>0.53x</td>
<td>0.54x</td>
</tr>
<tr>
<td>% growth in Revenue (16x)</td>
<td>(0.16x)</td>
<td>(0.23x)</td>
<td>0.46x</td>
<td>0.26x</td>
<td>0.30x</td>
<td>0.09x</td>
<td>0.48x</td>
<td>0.00x</td>
<td>0.04x</td>
<td>0.03x</td>
<td>0.02x</td>
<td>-</td>
</tr>
<tr>
<td>Revenue to Total Assets</td>
<td>0.45x</td>
<td>0.31x</td>
<td>0.15x</td>
<td>0.12x</td>
<td>0.12x</td>
<td>0.12x</td>
<td>0.18x</td>
<td>0.17x</td>
<td>0.17x</td>
<td>0.17x</td>
<td>0.17x</td>
<td>0.18x</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>0.00x</td>
<td>0.15x</td>
<td>0.16x</td>
<td>0.05x</td>
<td>(1.50x)</td>
<td>5.39x</td>
<td>0.97x</td>
<td>0.48x</td>
<td>0.34x</td>
<td>0.26x</td>
<td>0.22x</td>
<td>0.18x</td>
</tr>
</tbody>
</table>

### Capacity adequacy indicators

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
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<th>2026</th>
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</tr>
</thead>
<tbody>
<tr>
<td>DSCR</td>
<td>-</td>
<td>-</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Debt to Equity ratio (7.0X)</td>
<td>(7.0X)</td>
<td>(7.0X)</td>
<td>(21.15X)</td>
<td>(32.42X)</td>
<td>(106.23X)</td>
<td>472.32X</td>
<td>13.22X</td>
<td>6.53X</td>
<td>4.09X</td>
<td>2.85X</td>
<td>2.09X</td>
<td>1.58X</td>
</tr>
<tr>
<td>Debt to EBITDA (51.86x)</td>
<td>51.86x</td>
<td>4,361.20x</td>
<td>161,263.56x</td>
<td>32.06x</td>
<td>29.68x</td>
<td>10.31x</td>
<td>10.22x</td>
<td>9.29x</td>
<td>8.57x</td>
<td>7.85x</td>
<td>7.15x</td>
<td>6.83x</td>
</tr>
<tr>
<td>Leverage ratio</td>
<td>1.11x</td>
<td>1.11x</td>
<td>1.05x</td>
<td>1.03x</td>
<td>1.01x</td>
<td>1.00x</td>
<td>0.93x</td>
<td>0.97x</td>
<td>0.91x</td>
<td>0.75x</td>
<td>0.69x</td>
<td>0.63x</td>
</tr>
<tr>
<td>Leverage ratio (LT)</td>
<td>1.24x</td>
<td>1.20x</td>
<td>1.08x</td>
<td>1.03x</td>
<td>1.01x</td>
<td>1.00x</td>
<td>0.94x</td>
<td>0.97x</td>
<td>0.91x</td>
<td>0.74x</td>
<td>0.68x</td>
<td>0.62x</td>
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</tbody>
</table>

### Liquidity indicators

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<tr>
<th></th>
<th>2019</th>
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<th>2023</th>
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<th>2027</th>
<th>2028</th>
<th>2029</th>
<th>2030</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current ratio</td>
<td>1.83x</td>
<td>1.80x</td>
<td>1.30x</td>
<td>1.14x</td>
<td>1.21x</td>
<td>1.19x</td>
<td>1.13x</td>
<td>1.02x</td>
<td>0.97x</td>
<td>0.94x</td>
<td>0.93x</td>
<td>0.93x</td>
</tr>
</tbody>
</table>
VIII. FINANCIAL COVENANTS

54. DSCR is more than 1
IX. APPENDIX

TOR for International FM & Institutional Development Specialist

Expertise: Financial Management & Institutional Development

Source: International

Objective and Purpose of the Assignment

To support KazAvtoZhol (KAZ) in implementation of the above loan project, specifically to help address operational and capacity issues identified in the Financial Management Assessment of KAZ.

Scope of Work

The International Financial Management & Institutional Development Specialist (the Consultant) will serve as a key full-time member of the Project Implementation Unit for the loan, attached to KAZ and engaging with senior KAZ management to provide full-time continuous support to KAZ in the institutional development and evolution of its financial management and financial planning functions, and of the systems needed to support those functions general, and especially to ensure effective implementation of the loan project by KAZ.

Detailed Tasks and/or Expected Output

The Consultant's tasks will include but not be limited to the following:

- Develop and maintain a high degree of familiarity with and propose improvements to the following:
  - KAZ's FM systems, procedures, functions, and responsibilities of all KAZ FM personnel;
  - GOK financial and institutional reporting requirements of KAZ, including feeding into ministerial reporting by Committee on Roads to MID and MID to the Prime Minister's office's Project Management Center;
  - Internal information management needs and the ability of existing KAZ MIS systems to meet those needs, formulate proposals regarding additional MIS needed to meet the changing requirements of KAZ
- Continuously assess the adequacy of KAZ FM organization and procedures in light of the evolving needs of the project for implementation and of KAZ as an organization, and provide suggestions to senior KAZ management to improve KAZ FM and operations in general;
- Liaise with and report to ADB KARM and HQ as needed;
- Prepare and submit such reports to ADB from time to time as may be agreed detailing FM issues which have arisen or been identified during the reporting period and describing steps being taken to resolve them; and
- Play an active role as may be required from time to time in the general management of the projects.

Minimum Qualification Requirements
University degree in Business, Finance, Commerce, or related fields, with a professional designation in Accounting (e.g. CPA, CA).

The Consultant shall have (i) at least 10 years' relevant experience in public administration management and/or finance, preferably in a CIS country; (ii) previous experience in a similar capacity in the Central Asia region, preferably in an IFI-financed transportation project; (iv) extensive experience in development project implementation; (v) sound understanding of ADB’s guidelines and procedures; and (vi) excellent communication and reporting skills in both English and Russian.

Minimum General Experience 15 Years
Minimum Specific Experience (relevant to assignment) 10 Years
Regional/Country Experience Necessary
Russian language fluency necessary

Schedule and Places of Assignment: Full-time, Astana Kazakhstan, with occasional field travel within Kazakhstan, Regionally.