

FINANCIAL MANAGEMENT ASSESSMENT

A. Introduction

1. A financial management assessment (FMA) for the State Joint-Stock Company Uzbekenergo (Uzbekenergo), the project executing agency, was conducted as part of the Samarkand Solar Power Project (the project) at the same time as for the Takhiatash Efficiency Improvement Power Plant Project¹ in accordance with Asian Development Bank's (ADB) *Financial Management and Analysis of Projects* (2005). The FMA examines the financial management systems including accounting policies and procedures, internal and external audit functions, financial reporting and monitoring, and information systems of Uzbekenergo.

2. A FMA by the ADB on Uzbekenergo was conducted as part of the Talimarjan Power Project² in 2009 and an update of this FMA was undertaken in 2011 by the ADB as part of the Advanced Electricity Metering Project.³ The World Bank also conducted a review of Uzbekenergo's financial management in March 2012.⁴ These reports were reviewed as part of this assessment.

B. Accounting Standards and Financial Reporting in Uzbekistan

3. The National Account Standards (NAS) interpreted the Law on Accounting which regulates the financial statement preparation and publication of all public interest entities including joint-stock companies. The government has been implementing changes to its statutory framework with the objective to strengthen the creditability of its accounting system. The NAS was developed based on the International Accounting Standards (IAS) and the International Financial Reporting Standard (IFRS). However, there still remain significant differences between the NAS and IFRS as the government has undertaken a conservative approach in introducing changes to the system in order to ensure better compatibility and smooth transition.⁵

4. Accounting and reporting procedures are regulated by the accounting legislation of Uzbekistan, including National Accounting Standards of the Republic of Uzbekistan (NAS), which are published by the Ministry of Finance (MOF) of the Republic of Uzbekistan. Although NAS were based on IAS, statutory accounting framework substantially differs from IFRS. The following are the examples of the areas of key differences between the NAS and IFRS, including accounting for and disclosure of: financial instruments, impairment of assets, investments in subsidiaries, associates and joint ventures, and deferred tax.⁶ Related Public Accounting and International Public Sector Accounting Standards (IPSAS), it has to be remarked that the MOF of the Republic of Uzbekistan has adopted a Public Financial

¹ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Republic of Uzbekistan for the Takhiatash Power Plant Efficiency Improvement Project*. Manila

² ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Propoposed Loans to the Republic of Uzbekistan for the Talimarjan Power Project*. Manila

³ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Uzbekistan for the Advance Electricity Metering Project*. Manila.

⁴ World Bank. Report No: 66259-UZ. Project Appraisal Document on a Proposed loan in the Amount of US\$180 million to the Republic of Uzbekistan for the Advanced Electricity Metering Project. March 1, 2012.

⁵ For instance, while NAS is less stringent on financial reporting and disclosure than IFRS, it requires to follow a certain reporting format and more detailed presentation of certain items in the financial statements. Details on the differences between NAS and IFRS are provided in the World Bank's Report on the Observance of Standards and Codes on the Republic of Uzbekistan, Accounting and Auditing. December 2008.

⁶ PWC, "Guide to doing business and investing in Uzbekistan" 2011 edition.

Management Reform Strategy 2007–2018, which has been published on Asian Development Bank. The Strategy states, inter alia: “Accordingly, it is planned to: promulgate new Uzbekistan public sector accounting standards in line with accrual-basis IPSAS; comply with GFSM 2001; and undertake budget accounting on a cash basis reflecting the GFSM 2001 classification structure.”⁷

5. Latest assessment finds that while there is still insufficient expertise in the accounting profession in Uzbekistan and limited knowledge of internationally recognized accounting and auditing standards such as IFRS in both the public and private sectors, existing qualified accountants and auditors in Uzbekistan are knowledgeable about the NAS of Uzbekistan and that the compliance gap between the standards and actual practice is narrowing with progressive training and increasing alignment with the international standards of the NAS.⁸

C. Auditing Standards in Uzbekistan

6. National Standards on Auditing (NSA) serve as the auditing standards applicable in Uzbekistan. Similar to the NAS, the NSA was established based on the International Standards on Auditing (ISA) however it is not fully aligned with the ISA. The main issue of the practice of the auditing standards is the weak institutional audit function both at the regulator’s monitoring level, as well as at the corporate level. Issues such as unstable audit quality and limited assurance on the compliance and accuracy of the financial reports provided by auditors have been highlighted in the previous FMAs.⁹ It is still the case that the level of detail included in external auditor’s reports under NSA remains insufficient comparing to international reporting standards.¹⁰

7. The Audit Law of Uzbekistan enacted in 2000 stipulates that all audit firms must be registered with the Ministry of Justice and licensed by the MOF. Audit in Uzbekistan is performed in accordance with the Law of RUZ “On Audit Activity” and National Standards on Auditing.¹¹ The Law “On Audit Activity” requires auditors to follow Uzbek National Standards of Auditing (UNSA). Law of the Republic of Uzbekistan “On Auditing Activity” allows the existence of several professional accounting organizations. Currently there are three professional organizations in Uzbekistan: National Association of Accountants and Auditors (NAAA), Chamber of Auditors and Federation of Accountants, Auditors and Consultants. As per the Uzbek legislation, annual audit is mandatory for the following types of entities: joint stock societies, banks and credit unions, insurance companies, investment funds, charity and other social funds financed by voluntary contributions of legal entities and individuals, non-budget funds financed by obligatory contributions of legal entities and individuals, business entities with state share in their equity.¹²

8. The Center on Coordination and Control Over Functioning of the Securities Market and the tax authorities of Uzbekistan are responsible for monitoring compliance of financial reporting.

⁷ Deloitte, “IPSAS in your pocket”, 2013.

⁸ World Bank’s Report on the Observance of Standards and Codes on the Republic of Uzbekistan, Accounting and Auditing. December 2008, p. 36.

⁹ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Uzbekistan for the Advance Electricity Metering Project*. Manila.

¹⁰ In 2011 the World Bank conducted a review on local audit firms in attempt to determine their capacity to adequately audit projects financed by the World Bank in accordance with National Standards on Auditing and additional ISA conformed requirements. It was found that only two firms were deemed to be fully qualified for auditing the entity level. World Bank Report No: 66259-UZ, March 2012, p.36.

¹¹ National Association of Accountants and Auditors of Uzbekistan (NAAA Uz), June 2013.

¹² PWC, “Guide to doing business and investing in Uzbekistan” 2011 edition.

However the tax authorities conduct its checks and balances from the perspective of tax collection only. Furthermore, neither institution has the resource or the capacity to carry out effective monitoring work. The MOF conducts unsystematic inspection of the audited reports.

D. Financial Management Assessment of Uzbekenergo

9. Uzbekenergo is a 100% state-owned holding company for power generation, transmission, and distribution in Uzbekistan. It was established in August 2001 after public sector reorganization and is the legal successor of the former Ministry of Energy and Electrification. Incorporated as an open joint-stock company, Uzbekenergo has 52 subsidiaries with its shares ranging from 51% to 100% in each subsidiary. These subsidiaries include power generation, transmission, and distribution and supply companies. Most of those subsidiaries are incorporated as separate joint-stock companies.

1. Institutional Arrangements

10. Led by the Chief Accountant, the Department of Accounting and Finance of Uzbekenergo is responsible for the financial reporting of the company. Reporting to the Chief Accountant, 6 domestically qualified accountants are in charge of dealing with accounting issues related to investment projects. In addition, a team of 20 staff members collate and combine financial information received from the subsidiaries for preparation of combined financial reports to be submitted to the tax authorities. Training courses are provided annually in order to ensure compliance with any new accounting rules issued by the government. Lecturers include accounting experts from both the government as well as private sector accounting firms. The function is adequately staffed for the fulfillment of reporting requirement under the national standards. However knowledge of financial consolidation under the NAS), rules and practices of IFRS and ISA remains limited amongst existing staff.

2. Accounting Policies & Procedures and Financial Reporting & Monitoring

11. Uzbekenergo is required to prepare its accounting and financial reporting in accordance with the NAS of Uzbekistan. Financial statements are prepared on a quarterly and annual basis, consistent with NAS. In addition to statutory annual reporting Uzbekenergo develops income statements on a quarterly basis and monitors cash flows on a daily basis. Quarterly financial statements are required by tax authorities, and cash flow monitoring is used for the purposes of business practice rather than any external requirement.

12. With a special waiver granted by the government, Uzbekenergo has not consolidated its financial statements in accordance with the NAS. Further, aggregation of accounts and data consolidation are processed manually which seriously undermine the quality of the combined financial reports issued by Uzbekenergo as they do not reflect fully the financial performance of the entire company. Complexity of subsidiaries account and lack of skills for financial consolidation are major impediments to the improvement in the quality of Uzbekenergo's annual financial statements. To improve the quality of accounting practices, Uzbekenergo has undertaken a series of measures to capture the financial performance of the company's entire operations, with the assistance from the capacity development programs of the various international financial institutions.

13. For fiscal year ending 31 December 2011, the annual financial statements of Uzbekenergo were prepared based on NAS. The same will apply to fiscal year ending 31 December 2012. In order to meet the requirement of introducing IFRS reporting for the same

fiscal period, Uzbekenergo will also use software to convert the financial statements prepared in accordance with NAS to conform with IFRS.¹³ It is intended that for the fiscal year ending 31 December 2013, Uzbekenergo will adopt IFRS fully. The IFRS implementation and staff training are financially supported by the World Bank's capacity development program.¹⁴

14. The lack of experience within local auditing firms with ISA will create additional burden on Uzbekenergo which is required to prepare financial statements in accordance with both the NAS as well as IFRS while being subject to external auditing based on both NSA and ISA.

3. Internal Audit

15. As of January 2007, it is required by the government that an internal audit unit be established in each of the joint stock companies of total asset valued in excess of SUM 1 billion in Uzbekistan.¹⁵ Such internal audit unit should report to the company council (supervisory board) and not to the company's board of management. It is also required in Uzbekenergo's Charter that an internal audit function is to be formed. Previous FMAs have highlighted the lack of such function in Uzbekenergo.

16. In April 2013, an internal audit unit was established and has been in operation thereafter. It is expected that the World Bank will support the capacity development and training of the new internal audit unit.¹⁶

4. External Audit

17. Uzbekenergo appoints independent auditors to audit its annual financial statements. The audited financial statements and reports are submitted to the shareholders, the board of management and the tax authorities of Uzbekistan. These reports are not publically available. The auditors are selected through a competitive bidding process from a list of firms approved by the State Property Committee and MOF every year. The financial statements of fiscal year ending 31 December 2010 were audited by a locally based auditing company in accordance with the national standards on auditing.

18. Under Presidential Resolution 48 article 442 of 2010, Uzbekenergo is required to adopt ISA for external auditing of its financial statements during the period 2011-15. An international audit firm was appointed to prepare an ISA conformed audited report on the financial statements of the Uzbekenergo's Executive Office and Talimarjan Unitary Enterprise for fiscal year ending 31 December 2011 through the support from ADB (footnote 2). The results indicate the need for further improvements, among others, in the classification methods and impairment provisions on account receivables, the scope of account consolidation, and accounting system improvement.

19. For the fiscal year ending 31 December 2012, Uzbekenergo has started to adopt International Financial Reporting Standards (IFRS) conversion with the plan for full conversion to cover all subsidiaries for the fiscal year ending 31 December 2013. The capacity development plan under other ADB loan projects will address the training of IFRS specialists as

¹³ The introduction of IFRS reporting is a requirement of the World Bank Talimarjan Transmission Project (Loan Number 8009-UZ). The original requirement was for Uzbekenergo to introduce IFRS starting from fiscal year ending 31 December 2011. The timeframe has been subsequently amended.

¹⁴ World Bank. Loan Number 8009-UZ. Talimarjan Transmission Project.

¹⁵ Resolution of the Cabinet of Ministers on 16 September 2006.

¹⁶ World Bank. Loan Number 8009-UZ. Talimarjan Transmission Project.

well as the strengthening of information systems of Uzbekenergo with the objective of improving its financial management capability (footnote 2).

5. Information System

20. Uzbekenergo utilizes the Russian-based accounting software (1C Enterprise) for its accounting information systems. The 1C Enterprise system enables the Department of Accounting and Finance to (i) respond to operational and project-related queries on specific accounts; (ii) record transactions in the reporting period; and (iii) generate financial reports for both external and internal users. However, Uzbekenergo does not have an integrated computerized management information system. As a result, management account reporting is prepared manually based on ad hoc requests. The consolidation of financial data of the subsidiaries is also undertaken manually due to inadequate information system.

21. The accounting system requires significant update in order to allow Uzbekenergo for adopting IFRS as well as achieving full financial consolidation across all entities. The capacity development program under this project and other ADB loan project will seek to strengthen the information systems of Uzbekenergo with the objective to improve its financial management capability (footnote 2).

6. Risk Assessment and Mitigation Measures

22. Table 1 summarizes risk assessment and proposed mitigation measures.

Table 1: Financial Management Risks

Risk	Risk Assessment	Management Plan and/or Mitigation Measures	Risk after Mitigation
1. Inherent risks	High	The project management unit (PMU) to be supported by international consultants. Training on ADB procedures to be provided.	Medium
2. Flow funds arrangements	Substantial	ADB direct payment and commitment letters procedures are to be used for the project. No imprest account will be established. Relending agreement between the Ministry of Finance and Uzbekenergo to be submitted to ADB.	Low
3. Staffing	High	Uzbekenergo to be responsible for retaining adequate staffing and timely payment of salaries to staff. Recruitment and training of staff for international financing reporting standards (IFRS) to be implemented by Uzbekenergo with the help of international consultant.	Medium
4. Accounting policies, procedures, and systems	Substantial	An accounting system to be established and maintained for the project in order to minimize risk. IT systems diagnosis and strategy development to be carried out by international consultant to identify the weaknesses and to design mitigation plan including upgrading accounting system and the introduction of an integrated management information system. Recruitment of or internally trained IFRS accountants to introduce the adoption of IFRS. Documented procedures and staff training to be provided to retain institutional knowledge.	Medium
5. Internal audit	Substantial	Adequate staffing in the newly established internal audit unit and sufficient training to be provided by Uzbekenergo through the help of international consultant.	Medium

Risk	Risk Assessment	Management Plan and/or Mitigation Measures	Risk after Mitigation
6. External audit	Substantial	Loan/Project Agreements require Uzbekenergo's financial statements and project financial statements be audited in accordance with international standards on auditing (ISA) by auditor acceptable to ADB. Uzbekenergo will submit to ADB the audited project financial statements within 6 months of the end of the fiscal year.	Medium
7. Reporting and monitoring	High	A reporting system, which will have functionality for automatic generation of financial reports to be established and maintained for the project. Implementation consultants will be recruited to assist PMU in supervising the project implementation, recording project costs, preparing withdrawal applications and progress reports.	Medium
8. Information systems	High	Information systems and processes to be enhanced to meet the demands of organization, ensure operational stability, and allow for full consolidation of management information as well as financial data.	Medium
Overall	High		Medium

7. Implementation Plan

23. The project management unit (PMU) does not have a staff familiar with ADB procedures. Implementation consultants will be recruited to assist PMU in supervising the project implementation, recording project costs and preparing withdrawal applications and progress reports.

24. Proposed actions to mitigate the risks at the EA level include a capacity development program to be financed as part of this project and other similar programs under different donor loan projects.

E. Conclusion

25. Uzbekenergo's accounting policies, procedures and financial reporting are generally in compliance with the current NAS of Uzbekistan. It has adopted ISA for the external audit of its entity financial statements. For the adoption of IFRS and full consolidation of financial information of all subsidiaries, Uzbekenergo through the support from ADB and other donors, has taken the necessary steps. As a result of the proposed changes, it is expected that there will be positive changes in the accounting procedures, financial reporting, and management reporting systems in the next three years.