



# Report and Recommendation of the President to the Board of Directors

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Project Number: 52256-003  
August 2019

## Proposed Small Expenditure Financing Facility Kyrgyz Republic: Multisector Activities Support Facility

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Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 13 August 2019)

Currency unit	–	som (Som)
Som1.00	=	\$0.0143191187
\$1.00	=	Som69.836700

## ABBREVIATIONS

ADB	–	Asian Development Bank
CPS	–	country partnership strategy
O&M	–	operation and maintenance
SEFF	–	small expenditure financing facility
WTP	–	water treatment plant

## NOTE

In this report, "\$" refers to United States dollars unless otherwise stated.

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## SMALL EXPENDITURE FINANCING FACILITY AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 52256-003	
<b>Facility Name</b>	Multisector Activities Support Facility	<b>Department/Division</b>	CWRD/CWUW
<b>Country Borrower</b>	Kyrgyz Republic Ministry of Finance	<b>Executing Agency</b>	Ministry of Finance
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ Water and other urban infrastructure and services	Urban sanitation		0.20
	Urban solid waste management		0.80
	Urban water supply		3.50
Agriculture, natural resources and rural development	Rural water supply services		2.50
Energy	Energy utility services		0.50
Transport	Road transport (non-urban)		2.50
		<b>Total</b>	<b>10.00</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
Environmentally sustainable growth (ESG)	Eco-efficiency	<b>ADB Financing</b>	
	Global and regional transboundary environmental concerns	Adaptation (\$ million)	0.50
	Urban environmental improvement	Mitigation (\$ million)	1.00
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	No categorization	
Knowledge solutions (KNS)	Application and use of new knowledge solutions in key operational areas		
	Pilot-testing innovation and learning		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Rural	Medium
Household Targeting	No	Urban	High
General Intervention on Poverty	No		
SDG Targeting	Yes		
SDG Goals	SDG6, SDG7, SDG9, SDG11, SDG13		
<b>6. Risk Categorization</b>	Low		
<b>7. Safeguard Categorization</b>	Environment: B    Involuntary Resettlement: C    Indigenous Peoples: C		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>10.00</b>	
Special Funds Resources (ADF grant)		10.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>2.50</b>	
Government		2.50	
<b>Total</b>		<b>12.50</b>	
<b>Currency of ADB Financing:</b> USD			



## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed small expenditure financing facility (SEFF) to the Kyrgyz Republic for the Multisector Activities Support Facility. The facility will finance a series of small-value activities to support and complement larger projects financed by the Asian Development Bank (ADB) in the country.

2. In particular, the facility will fund (i) project preparatory support for design and procurement readiness of ensuing projects; (ii) small pilot projects to demonstrate new technologies, international standards, and management approaches for potential scale-up under ensuing projects; (iii) project implementation support for ongoing ADB projects to ensure the efficient delivery of project outcomes; and (iv) capacity building and supplemental support for completed ADB projects in operation and maintenance (O&M), asset management, facility upgrading to meet critical needs, and post-disaster rehabilitation assistance. The first activity to be financed under the facility will enhance the sustainability of a completed ADB-financed investment in urban water project.

## II. THE FACILITY

### A. Rationale

3. **Country portfolio overview.** Despite ADB's assistance portfolio in the Kyrgyz Republic tripling from 2000 to 2018, capacity constraints remain in the country, resulting in project start-up delays that affect contract awards and disbursement rates. Other challenges include inadequate designs and cost overruns.

4. **Project sustainability risks.** Key factors leading to sustainability risks in ADB's project portfolio include (i) low tariffs (below intended O&M cost recovery levels), (ii) weak operational efficiency through traditional technologies, (iii) weak O&M capacity, and (iv) limited resources and knowledge of asset management. Moreover, there is an immediate need to support upgrades to completed water supply infrastructure to meet updated standards.

5. **Strategic context.** ADB's country partnership strategy (CPS), 2018–2022 for the Kyrgyz Republic,<sup>1</sup> which is aligned with government priority sectors under the Development Program of the Kyrgyz Republic,<sup>2</sup> prioritizes support for minimizing project start-up delays, and improving procurement and project implementation capacity through technical assistance and on-the-ground support from ADB's resident mission. In line with the CPS, the SEFF will support the government's strategic priorities. The proposed assistance under the facility is also aligned with the Strategy 2030 operational priorities to (i) address remaining poverty and reduce inequalities, (ii) accelerate progress in gender equality, (iii) make cities more livable, (iv) tackle climate change and enhance environmental sustainability, (v) promote rural development and food security, (vi) strengthen governance and institutional capacity, and (vii) foster regional cooperation and integration.<sup>3</sup>

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<sup>1</sup> ADB. 2018. *Country Partnership Strategy: Kyrgyz Republic, 2018–2022—Supporting Sustainable Growth, Inclusion, and Regional Cooperation*. Manila.

<sup>2</sup> Government of the Kyrgyz Republic. 2018. *Development Program of Kyrgyz Republic For the Period 2018–2022: "Unity, Trust, Creation."* Bishkek (approved 20 April).

<sup>3</sup> ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

6. **Proposed facility and ADB value addition.** The SEFF will deliver on CPS priorities by (i) supporting early design work and advanced procurement actions to alleviate project start-up bottlenecks; (ii) strengthening the government's project implementation capacity; (iii) introducing new technologies, standards, and management approaches; (iv) enhancing the sustainability of ADB-financed investments through improved asset management and O&M practices; and (v) bringing completed infrastructure investments in conformance with up-to-date performance standards.

## B. Facility Description

7. **Objective.** Activities under the facility will improve the efficiency, sustainability, responsiveness, and readiness of ADB-financed operations. They will contribute to the achievement of the outputs and outcomes of the linked ADB-financed projects.

8. **Facility scope.** The facility will finance a series of small-scale activities related to one or more of the outputs (para. 9).<sup>4</sup> Each activity will be linked to a planned, ongoing, or completed ADB-financed project. Under the current CPS, priority sectors are agriculture, natural resources, and rural development; education; energy; public sector management; transport; and water and other urban infrastructure and services.

9. The following outputs will contribute to the achievement of the outputs and outcomes of the linked ADB-financed projects.

10. **Output 1: Project implementation readiness for ensuing projects improved.** The facility will support project preparation, design activities, and institutional strengthening for investments to be financed under one or more ensuing ADB-financed projects, including the Naryn Rural Water Supply and Sanitation Development Program—the country's first results-based lending operation—planned for 2019 approval.<sup>5</sup>

11. **Output 2: New technology, innovation, or improvement in design standards pilot-tested.** The facility will support pilot-testing advanced technologies and management approaches to reduce life-cycle costs, improve service efficiency and quality, and minimize negative environmental and social impacts. Development of road asset management is an example of a new technology or management approaches activity under the facility.

12. **Output 3: Project efficiency and sustainability enhanced.** The facility will enhance project efficiency and sustainability, including capacity and implementation support for ongoing projects, post-disaster rehabilitation, O&M, and upgrading of completed infrastructure investments to conform with up-to-date performance standards. The first activity under this output is the Osh–Plotina water treatment plant (WTP) chlorine neutralization unit.

## C. Scope of First Activity

13. The first activity under the facility will support the physical upgrades of the chlorine neutralization unit at the Osh–Plotina WTP, completed in September 2016 under the Emergency Assistance for Recovery and Reconstruction project.<sup>6</sup> The unit will be upgraded to a higher

<sup>4</sup> List of Indicative Activities (accessible from the list of linked documents in the Appendix).

<sup>5</sup> ADB. [Kyrgyz Republic: Naryn Rural Water Supply and Sanitation Development Program](#).

<sup>6</sup> ADB. 2010. [Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to the Kyrgyz Republic for Emergency Assistance for Recovery and Reconstruction](#). Manila (total actual implementation cost: \$98,249,844).



international standard and provide 400,000 people with access to safe and reliable water supply. The activity will improve the development impact and sustainability of the project.

14. A key objective of the project approved in September 2010 was to rebuild dwellings and improve the essential public infrastructure, and a project subcomponent included the rehabilitation of the Osh–Plotina WTP. The project completion report concluded that the project was *successful*, but noted that upgrading the chlorine neutralization unit at the Osh–Plotina WTP to meet up-to-date water supply standards with the highest safety levels remains a priority.<sup>7</sup> Given its urgency, the government requested the chlorine neutralization unit upgrade at the Osh–Plotina WTP as the first activity under the facility. The upgraded chlorine neutralization unit will ensure enhanced neutralization of any chlorine leakage, which is essential to the safe and sustainable operations of the WTP. The activity will enhance ADB’s development impact at an overall cost of \$625,000.<sup>8</sup>

#### D. Summary Cost Estimates and Financing Plan

15. The government has requested a facility in an amount up to \$10 million from ADB’s Special Fund resources (Asian Development Fund) to help finance the activities. The facility amount includes the total estimated cost of activities to be financed, including taxes and duties, physical and price contingencies, and other charges during implementation (Table 1).

**Table 1: Summary Cost Estimates**

Item	Amount <sup>a</sup> (\$ million)	Share (%)
<b>A. Base Cost<sup>b</sup></b>		
1. Output 1: Project implementation readiness for ensuing projects improved	3.5	28.0
2. Output 2: New technology, innovation, or improvement in standards pilot-tested	1.5	12.0
3. Output 3: Project efficiency and sustainability enhanced <sup>c</sup>	5.0	40.0
<b>Subtotal (A)</b>	<b>10.0</b>	<b>80.0</b>
<b>B. Contingencies<sup>d</sup></b>	<b>2.5</b>	<b>20.0</b>
<b>C. Financial Charges During Implementation</b>	<b>0.0</b>	<b>0.0</b>
<b>Total (A+B+C)</b>	<b>12.5</b>	<b>100.0</b>

Note: Cumulative costs during the facility period, estimated at the time of approval.

<sup>a</sup> Includes taxes and duties of \$2.5 million. Such amount does not represent an excessive share of the facility cost. The government will finance taxes and duties through exemptions.

<sup>b</sup> In mid-2019 prices as of 27 June 2019.

<sup>c</sup> The first activity will be the upgrade of the Osh–Plotina water treatment plant chlorine neutralization unit, at a total estimated cost of \$625,000.

<sup>d</sup> Physical contingencies computed at 5% for civil works; and 2% for field research and development, training, surveys, and studies if the facility’s scope is beyond project readiness (i.e., pilot testing, post-project support, and/or support for an ongoing project). Price contingencies computed at average of 1.6% on foreign exchange costs and 4.4% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

Source: Asian Development Bank estimates.

16. The proposed facility will consist of multiple subgrants to support different sectors, subject to the government’s submission of related activity requests, the execution of the activity subgrant agreement for each activity, and the fulfillment of the terms and conditions and undertaking in the facility agreement. The first activity to be supported under the facility—the upgrade of the chlorine

<sup>7</sup> ADB. 2017. [Completion Report: Emergency Assistance for Recovery and Reconstruction in the Kyrgyz Republic](#). Manila.

<sup>8</sup> Costs associated with rehabilitating the unit represent 5% of the total project cost and will benefit about 400,000 people.

neutralization unit at the Osh–Plotina WTP—is estimated to cost \$625,000. The government has requested a subgrant of \$500,000 under the facility to help finance this activity. The ADB subgrant will finance civil works and the audit of activity financial statements, while the government will finance taxes and duties, and project management office operational costs.

17. The following types of expenditure will be eligible for financing under the facility: consulting services, non-consulting services, small works, and goods.

18. The summary financing plan is in Table 2.

**Table 2: Summary Financing Plan**  
(\$ million)

Source	Estimated Year of Approval					Amount	Share of Total (%)
	2019	2020	2021	2022	2023		
Asian Development Bank							
Special Funds resources (ADF grant)	0.50	2.60	3.70	2.20	1.10	<b>10.00</b>	80.0
Government	0.13	0.65	0.92	0.55	0.25	<b>2.50</b>	20.0
<b>Total</b>	<b>0.63</b>	<b>3.25</b>	<b>4.62</b>	<b>2.75</b>	<b>1.25</b>	<b>12.50</b>	<b>100.0</b>

ADF = Asian Development Fund.

Notes: Based on indicative list of projects, which at the time of approval includes activity subgrants greater than the facility. Numbers may not sum precisely because of rounding.

Source: Asian Development Bank estimates.

## E. Implementation Arrangements

19. The executing agency for all activities to be financed under the facility will be the Ministry of Finance, which has been involved in several previous ADB operations.

20. The implementing agency for the first activity—the Department of Drinking Water Supply and Sewerage Development under the State Agency for Water Resources—will be responsible for overall activity coordination and management. The agency is responsible for issuing state technical expertise certificates for all technical projects and is fully aware of the implemented actions done under the Emergency Assistance for Recovery and Reconstruction project. Implementing agencies for subsequent facility activities will be determined based on the nature of the activities to be supported under the facility.

21. Implementation arrangements of the facility, including specific arrangements for the first activity, are summarized in Table 3 and described in detail in the activity administration manual.<sup>9</sup>

**Table 3: Implementation Arrangements**

Aspects	Arrangements
SEFF availability period	October 2019–October 2024
Estimated completion date for the first activity	December 2020
Management	
(i) Executing agency for the SEFF	Ministry of Finance
(ii) Implementing agencies for the SEFF activities	First activity: DDWSSD; subsequent activities: to be determined based on the nature and scope of the activity to be supported under the SEFF

<sup>9</sup> Activity Administration Manual (accessible from the list of linked documents in Appendix).

Aspects	Arrangements
(iii) Implementation units for the SEFF activities	To be determined for each activity subgrant. For the first activity, the implementing agency will establish a project management office comprising 5 staff to support implementation.
Procurement	The first activity will include 1 works contract for \$0.50 million. Each activity under the facility will have an associated procurement plan. All procurement financed under the facility will follow ADB's Procurement Policy (2017, as amended from time to time) and Procurement Regulations (2017, as amended from time to time).
Advance contracting	To ensure procurement readiness, all individual activities to be supported by the facility are anticipated to undertake advance contracting. The first activity subgrant will initiate procurement in the third quarter of 2019.
Disbursement	Disbursement of subgrant proceeds for all activities will follow ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.

ADB = Asian Development Bank, DDWSSD = Department of Drinking Water Supply and Sewerage Development, SEFF = small expenditure financing facility.

Source: Asian Development Bank.

### III. DUE DILIGENCE

#### A. Economic and Financial Viability

22. Economic and financial analysis will be carried out, as appropriate, for each activity financed under the facility to confirm that the larger ADB-financed project that is being supported by the activity will remain viable. As described in para. 12, the first activity will enhance the treatment performance of the chlorine neutralization unit at the Osh–Plotina WTP. The water tariff levied by Vodokanal, the city's water utility, can sufficiently cover O&M costs.

23. The economic analysis for the completed project was updated to take into account the additional costs associated with the subgrant for the first activity. The analysis showed that the overall project will remain viable, with an economic internal rate of return of 18.7% compared with the 19.1% reflected on the project completion report and a financial internal rate of return of 2.4% compared with the initial estimate of 2.8%, as the outputs have not changed, and the increase in capital expenses is negligible in relation to the size of the linked project.

24. For subsequent activities, economic and financial analysis will be updated as appropriate, taking into account activity subgrants for the concerned projects.

25. The Ministry of Finance and ADB will agree on all activities to be financed under the facility, taking into consideration that (i) activities should be consistent with the CPS and the facility outputs, (ii) activities would not be classified *category A* for safeguards in line with ADB's Safeguard Policy Statement (2009), and (iii) the maximum activity size will not exceed \$3 million.

#### B. Governance

26. The financial management risk for the implementing agency for the first activity is *substantial*. Mitigating measures have been incorporated under the approved Issyk-Kul Wastewater Management Project that will ensure that the Department of Drinking Water Supply and Sewerage Development has (i) adequate staff to handle project financial management,

although they are unfamiliar with ADB's disbursement guidelines and procedures; (ii) an adequate accounting system that integrates project-specific accounting, budgeting, auditing, and reporting requirements; on top of (iii) the experience as an executing agency for projects financed by other international financial institutions, with responsibilities for grant disbursements and advance account management; and (iv) capacity for internal audit.

27. For subsequent activities, a financial management assessment will be undertaken for the designated implementing agencies.

28. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the Ministry of Finance. The specific policy requirements and supplementary measures are described in the activity administration manual (footnote 9). All activity subgrants under the facility will include integrity due diligence.<sup>10</sup>

### C. Safeguards

29. All activity subgrants under the facility will include activity-specific safeguard review and categorization. In compliance with ADB's Safeguard Policy Statement, the safeguard categories of the first activity subgrant are indicated below.<sup>11</sup> The facility will not support category A projects.

30. **Environment (category B).** An environmental assessment and review framework was prepared for the facility following the Safeguard Policy Statement to guide the preparation of environmental assessment reports. The first activity covering the chlorine neutralization unit at the Osh–Plotina WTP is *category B* for the environment, and initial environmental examination was prepared and disclosed on ADB's website.

31. **Involuntary resettlement (category C).** A land acquisition and resettlement framework has been prepared for the facility's subsequent activities following the Safeguard Policy Statement. The resettlement classification for the first activity is *category C* as no land acquisition and involuntarily resettlement is envisaged.

32. **Indigenous peoples (category C).** The first activity and all subsequent activities will not impact communities that may be defined as indigenous peoples under the Safeguard Policy Statement. The indigenous peoples' impact classification for the subgrant is *category C*.

### D. Summary of Risk Assessment and Risk Management Plan

33. The overall risk for the facility is *low* because of the nature and limited size of the activities to be supported. Significant risks and mitigating measures for the first activity are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>12</sup>

**Table 4: Summary of Risks and Mitigating Measures**

Risks	Mitigation Measures
Political and/or organizational. Government approval procedures by	Close government agency coordination will be maintained to minimize delays in procurement and approvals.

<sup>10</sup> No project performance audit report has been undertaken for the Kyrgyz Republic.

<sup>11</sup> ADB. [Safeguard Categories](#).

<sup>12</sup> Risk Assessment and Risk Management Plan in Small Expenditure Financing Facility Activity Summary Report for the First Activity.

Risks	Mitigation Measures
oversight agencies take longer than anticipated.	
<b>Financial management risk.</b> Implementing agency personnel lack knowledge and understanding of ADB's disbursement guidelines and procedures.	For the first activity subgrant, government staff with familiarity of ADB's disbursement guidelines and procedures will be assigned to the PMO; a project manual will be prepared, detailing ADB disbursement policies and procedures; training and consultant support will be provided; and accounting systems will be upgraded to facilitate the preparation of project financial statements and documentation of withdrawal applications.
<b>Procurement.</b> Implementing agency personnel are unfamiliar with ADB procurement procedures, resulting in procurement deficiencies and implementation delays.	For the first activity subgrant, staff of the implementing agency (including the PMO) will participate in ADB procurement training and be familiar with ADB's Procurement Policy (2017, as amended from time to time) and Procurement Regulations (2017, as amended from time to time). ADB will undertake prior review of all contract procurement and closely monitor contract implementation.

ADB = Asian Development Bank, PMO = project management office.

Source: Asian Development Bank.

#### IV. ASSURANCES

34. The government has assured ADB that implementation of activities under the facility shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, procurement, consulting services, financial management, and disbursement as described in detail in the facility agreement.

35. The government and the Ministry of Finance have agreed with ADB on certain covenants for the facility and the first activity, which are set forth in the draft facility agreement and short-form legal agreement for the first activity.

#### V. RECOMMENDATION

36. I am satisfied that the proposed small expenditure financing facility would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the small expenditure financing facility to the Kyrgyz Republic for the Multisector Activities Support Facility in an aggregate principal amount not exceeding \$10,000,000, which comprises the provision of grants from ADB's Special Funds resources (Asian Development Fund), on terms and conditions that are substantially in accordance with those set forth in the draft facility agreement presented to the Board.

Takehiko Nakao  
President

21 August 2019

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=52256-003-PRF>

1. Facility Agreement
2. List of Indicative Activities
3. Activity Report
4. Activity Administration Manual
5. Environmental Assessment and Review Framework
6. Initial Environmental Examination
7. Land Acquisition and Resettlement Framework