Kyrgyz Republic
Report on observance of standards and codes – Institutions
2022

CFRR
Centre for Financial Reporting Reform
WORLD BANK GROUP
Governance

KAREP
Kyrgyz Audit and Reporting Enhancement Project

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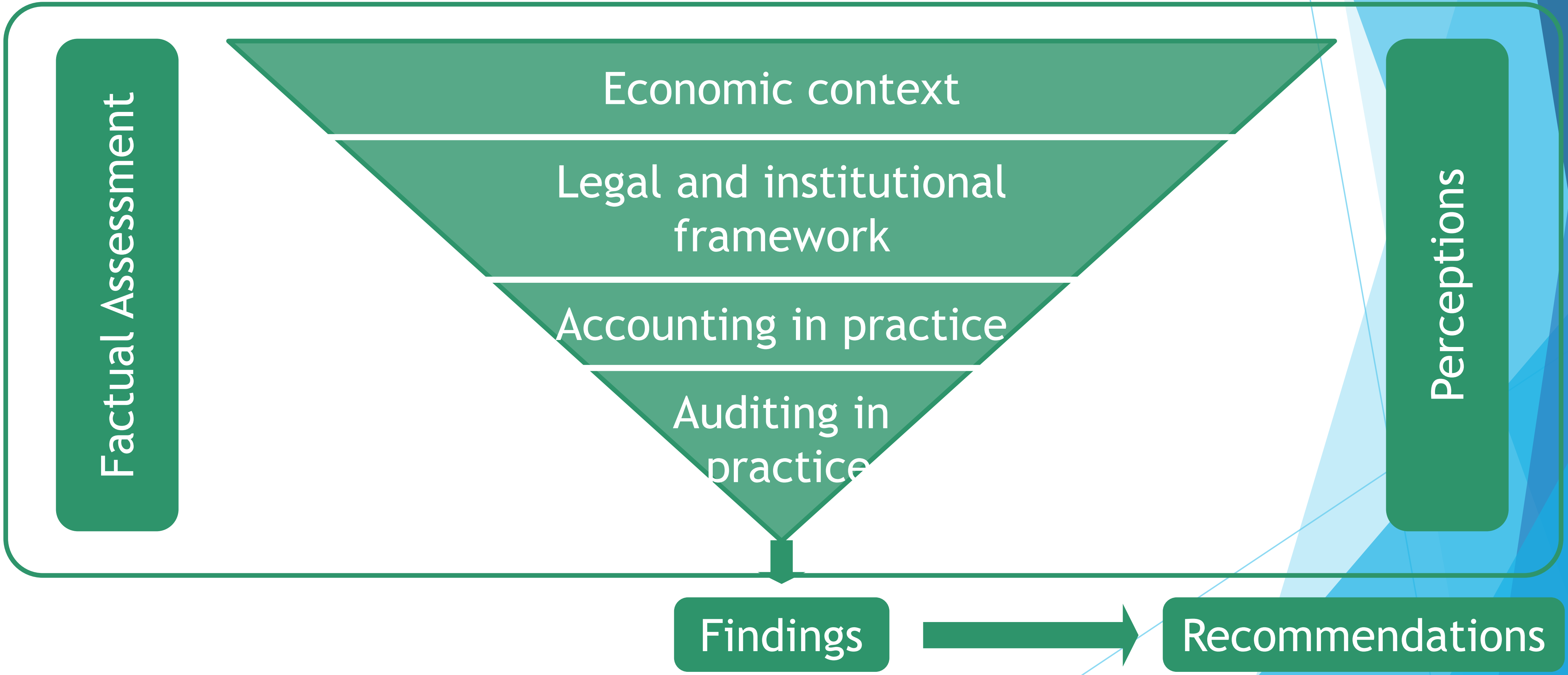
- Assessment Process

Purpose of the ROSC A&A

- ROSC A&A[1] assesses financial reporting and auditing standards, institutions, and practices in participating countries
- Reports form part of a joint initiative implemented by World Bank and IMF to review quality of implementation of internationally recognized standards and principles with a view to promoting financial and economic stability
- Report provides assessment of financial reporting and auditing requirements and practices within corporate sector in Kyrgyz Republic and makes recommendations
- Uses international benchmarks of good practice governing financial reporting and auditing in the assessment.
- This report updates an assessment which was published in 2008 and was undertaken following a formal request from the Kyrgyz Republic.

[1] Reports on the Observance of Standards and Codes Accounting and Auditing

Structure of the ROSC A&A



Scope of the ROSC A&A

Reviews accounting and auditing **Standards** and **Practices**.

Two objectives:

Assess the comparability of a country’s national accounting and auditing standards against the international equivalents

Assess the degree to which corporate entities comply with established accounting and auditing standards in a country

Set of core indicators
(7 "core" indicators)

A&A Standards	*Financial Reporting and Auditing Standards (ii)*
Requirements and Enforcement	*FR&A of Banks (iii)*; *FR&A of Listed Companies (iii)*; *FR & A of Insurance Companies (iii)*
	FR & A Exemptions and Simplifications for Commercial Enterprises, including SMEs (iii)
Skills	*Accountancy Profession (iv)*
Monitoring & Enforcement	*Audit Regulation, Quality Assurance, and Public Oversight (iii)*

7 indicators

1. A&A Standards
2. Financial Reporting and Auditing: Listed companies
3. Financial Reporting and Auditing: Banks
4. Financial Reporting and Auditing: Insurance companies
5. Financial Reporting and Auditing Exemptions and Simplifications for Commercial Enterprises, including SMEs
6. Accountancy Profession
7. Audit Regulation, Quality Assurance & Public Oversight

Tools and guidelines

Module A A&A Standards	Module B Institutional Framework for CFR	Module C Observed Practice
A.1 Financial Reporting Standards Analysis A.2 Auditing Standards Analysis	B.1 Commercial Enterprises B.2 Listed Companies B.3 Financial Sector – Banks B.4 Financial Sector – Insurance B.5 Accountancy profession B.6 Accountancy education B.7 Audit reg, QA & Public Oversight B.8 Accounting Standard-setting	C.1 Financial statement review C.2 Review of regulatory findings C.3 Perceptions survey

Core indicators

- Accounting and Auditing Standards

Accounting standards

- Law mandates the full adoption of IFRS and the IFRS for SMEs in the country
- PIEs and large businesses are required to adopt IFRS.
- Medium-sized businesses are to adopt IFRS for SMEs, with IFRS as an allowed alternative
- Small businesses can prepare financial statements using the simplified accounting rules established by the Government. Small businesses can voluntarily adopt the IFRS for SMEs

Auditing standards

- Audit Law 2021 mandates full adoption of ISAs and ISQMs
- The Law requires PIEs and large businesses to have annual statutory audits
- Other types of audit and audit of other entities can be conducted on a voluntary basis

Institutional Framework

Basis for Ratings

- *Detailed performance indicator rating guidance are in PDF files attached*

Example
Listed companies FR&A Indicator

Sub-indicator A: Financial Reporting and Auditing Requirements for Listed Companies

- A.1. Financial reporting requirements
- A.2. Audit requirements
- A.3. Timeliness and Public disclosure of financial reports

Sub-indicator B: Monitoring and Enforcement of the Financial Reporting Requirements of Listed Companies

- B.1. Review of the listed company's annual financial statements
- B.2. Communication with external auditors
- B.3. Reporting on the review of financial reporting of listed companies
- B.4. Supervisory measures and sanctions

Example
Listed companies rating matrix

Sub-indicator A:

1 = Minimum score; criteria for “2” rating not met

2 = Initial steps taken towards alignment with international good practice; however, significant gaps exist

3 = Some alignment with international good practice; however, gaps remain

4 = Substantial alignment with international good practice

Sub-indicator B:

1 = Minimum score; criteria for “2” rating not met

2 = Monitoring and enforcement procedures and processes have significant limitations

3 = Monitoring and enforcement procedures and processes have

Example

Listed companies FR&A Indicators

Example Sub-indicator A.1.: Financial Reporting and Auditing

RATING CRITERIA			
1	2	3	4
A.1. Financial reporting requirements			
Criteria for '2' rating not met	Listed companies are required to prepare legal entity financial statements on an annual basis, in accordance with prescribed financial reporting standards.	In addition to requirements under "2": Listed companies are required to prepare a management report (or management discussion and analysis MD&A). Listed companies are required to apply IFRS for consolidated annual financial statements.	In addition to requirements under "3": listed companies are required to prepare interim consolidated financial statements and to publish a statement on corporate governance.

Institutional Framework

- ***Findings and Considerations***

Background

- Significant progress since 2008, especially in regard
  - the introduction of new legislation and
  - the reorganization of the regulatory landscape
- However significant challenges remain stemming from:
  - Bedding down new processes
  - Skills development and experience with processes
  - Ongoing resource constraints
  - Further refinement of legislative and regulatory frameworks
- Education will be core to addressing many of the considerations identified

Good practices observed in the Kyrgyz Republic

Improvements since 2008 review

Changes to legislation to strengthen institutional accounting system

- Classifies entities and establishes a three-tier financial reporting requirement.
- Establishes a Public Depository for Financial Statements
- Adopts international standards and changes thereto through a formal process
- Empower regulators to perform reviews of all PIEs' financial statements, including auditor reports, and highlight inadequacies to the relevant regulatory agency.
- Establishes a three-tier professional qualification framework
- Enforces quality assurance requirements in respect of mandatory audits.

Reform of tertiary accounting education in the Kyrgyz Republic has begun; a report was finalized in June 2020 with KAREP support.

New laws and regulations

- Significant recent changes to legislation promulgated to strengthen the country's institutional accounting system:
  - Significant amendments to the Law on Accounting (2021) and
  - A new Law on Auditing Activities (2021)
- Operational and regulatory processes designed to give effect to the legislative changes are being established
- Too early to evaluate effect of the new laws in practice, and new processes take time to bed down,
- Considerable work performed on drafting regulations and manuals

Key considerations

Apply strengthened legal requirements

- General purpose financial statements should be clearly distinguished from prudential/regulatory reporting
- The following initiatives introduced by the new legislation should be bedded down and where appropriate reenforced as soon as feasible:
  - Regulatory requirements and powers
  - Public depository for entities preparing general purpose financial statements
  - Independent audit oversight function
  - Application of the existing requirements to SOEs
- A consolidated Code of Corporate Governance should be issued

Key considerations

Optimize reporting

- Optimize regulatory monitoring of quality of financial statements
- Report back on review findings to produce a cycle of improvement
- Support education initiatives
- New challenges – Covid and Climate change
  - Covid 19 has significantly impacted on economies
  - Investors and institutions will increasingly demand insights into sustainability
  - Crisis response offers a unique opportunity to rebuild stronger, greener and more equitable economies and institutions while leveraging the private sector.

Findings
Corporate reporting

Key considerations

Common positives

- Entities in the sectors reviewed are required to prepare IFRS compliant Financial statements
- Entities are required to report their annual financials statements with at most 5 months of yearend
- Newly introduced legislation substantially improves the regulatory environment, although as noted above the legislation has not yet been fully operationalised
- The new legislation provides for:
  - A public depository for financial statements,
  - An enhanced audit oversight function

Key considerations

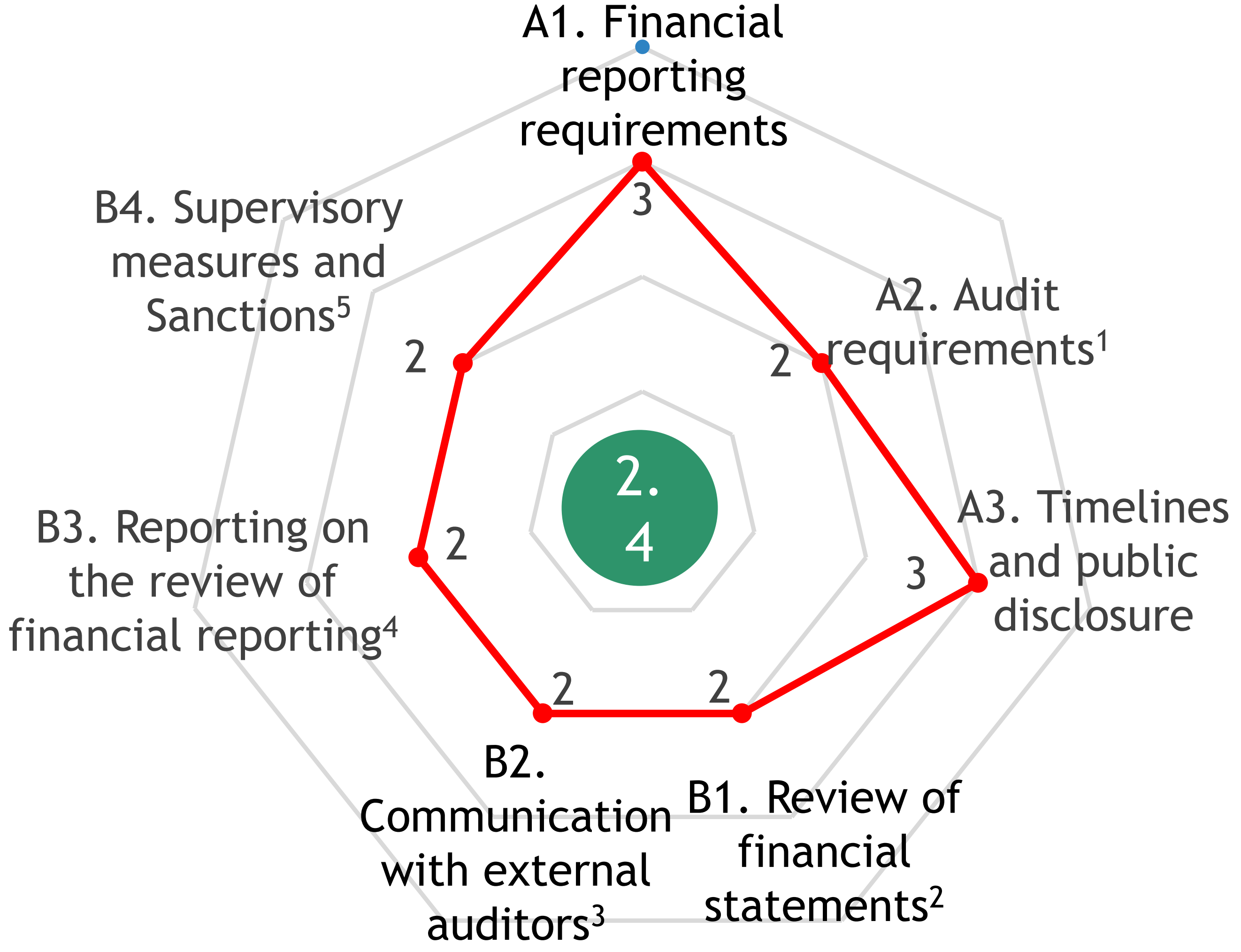
Common concerns

- No requirement for MD&A, and consequently no requirement for audit sign off
- Public interim financial statements are generally not required, and if required, are not required to be reviewed by auditors
- A public depository for financial statements exists but is not yet operational
- There are no specific protocols in place for regulators to hold meetings with the auditors, although some meetings do take place
- The outcome of financial statement reviews, when conducted, are not publicly communicated
- Moratorium on inspections (now lifted)
- Frequent examples of poor compliance with existing laws were observed

Corporate reporting

Listed entities

Performance indicators



Comments

1. No requirement for MD&A or other material to be signed off by auditors
2. Insufficient capacity
3. There are no specific protocols in place
4. There is a published report, but it does not deal with IFRS issues.
5. Moratorium on inspections (now lifted)

Key considerations - positives

Aside from the common positives referred to above

- Required to produce interim (quarterly) financial statements
- There is a code of corporate governance, and the company must declare compliance

Key considerations - concerns

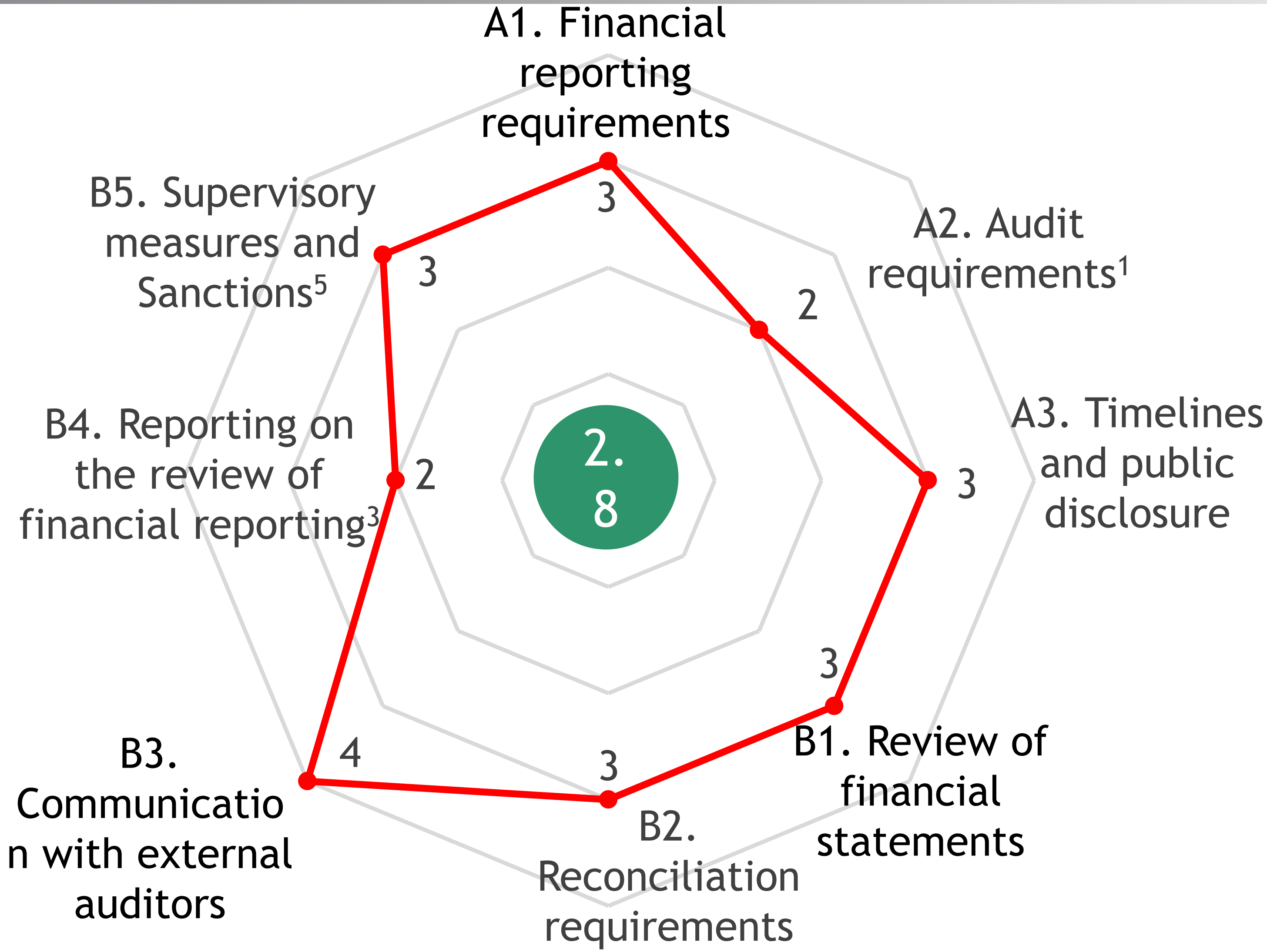
Aside from the common concerns raised above:

- Interim financial statements are not required to be reviewed by auditors
- The audit opinion and management letters are reviewed, but there is not a process for reviewing financial statements directly
- There is insufficient resources at the regulator to review IFRS compliance
- The reviews of financial statements do not focus on IFRS compliance, and the outcome of the reviews that are done are not publicly communicated
- Moratorium on inspections (now lifted)

Corporate reporting

Banking entities

Performance indicators



Comments

1. No requirement for MD&A
2. Published reports exclude compliance with IFRS

Key considerations - positives

Aside from the common positives raised above:

- Quantity of reporting under IFRS is generally better then other sectors
- Banks must report within 4 months of yearend

Key considerations - concerns

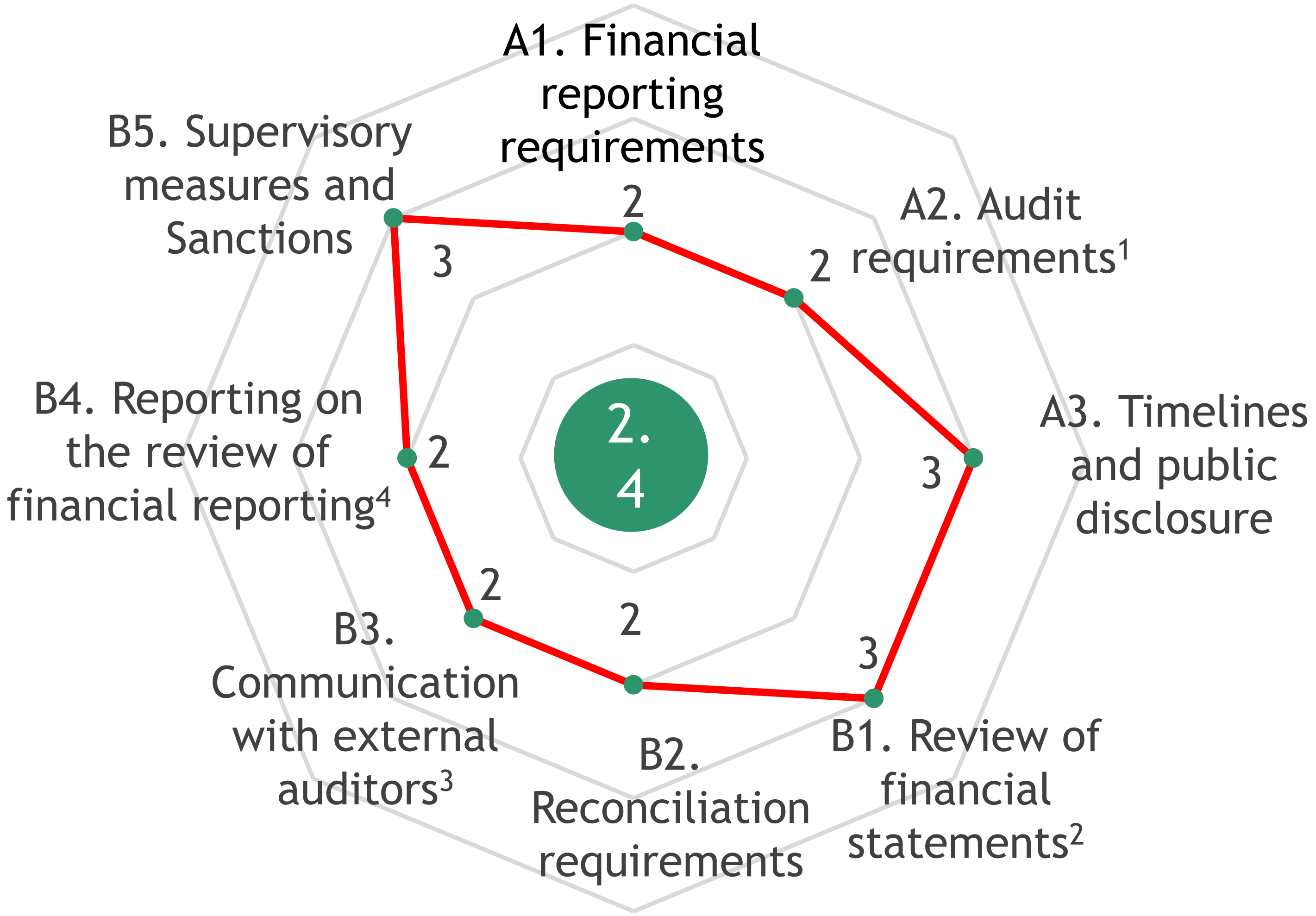
Aside from the common concerns raised above:

- Interim financial statements are not required to be reviewed by auditors
- There are no specific protocols in place for the regulator to hold meetings with the auditors, although regular meetings do take place
- The outcome of the reviews that are done are not publicly communicated

Corporate reporting

Microfinance entities

Performance indicators



Comments

1. No requirement for audit committees or MD&A
2. Reliance on external audit
3. Limited ability to influence audit
4. Published reports exclude compliance with IFRS

Key considerations - positives

Aside from the common positives raised above:

- Quantity of reporting under IFRS is generally better then other sectors
- NFCOs must report within 4 months of yearend

Key considerations - concerns

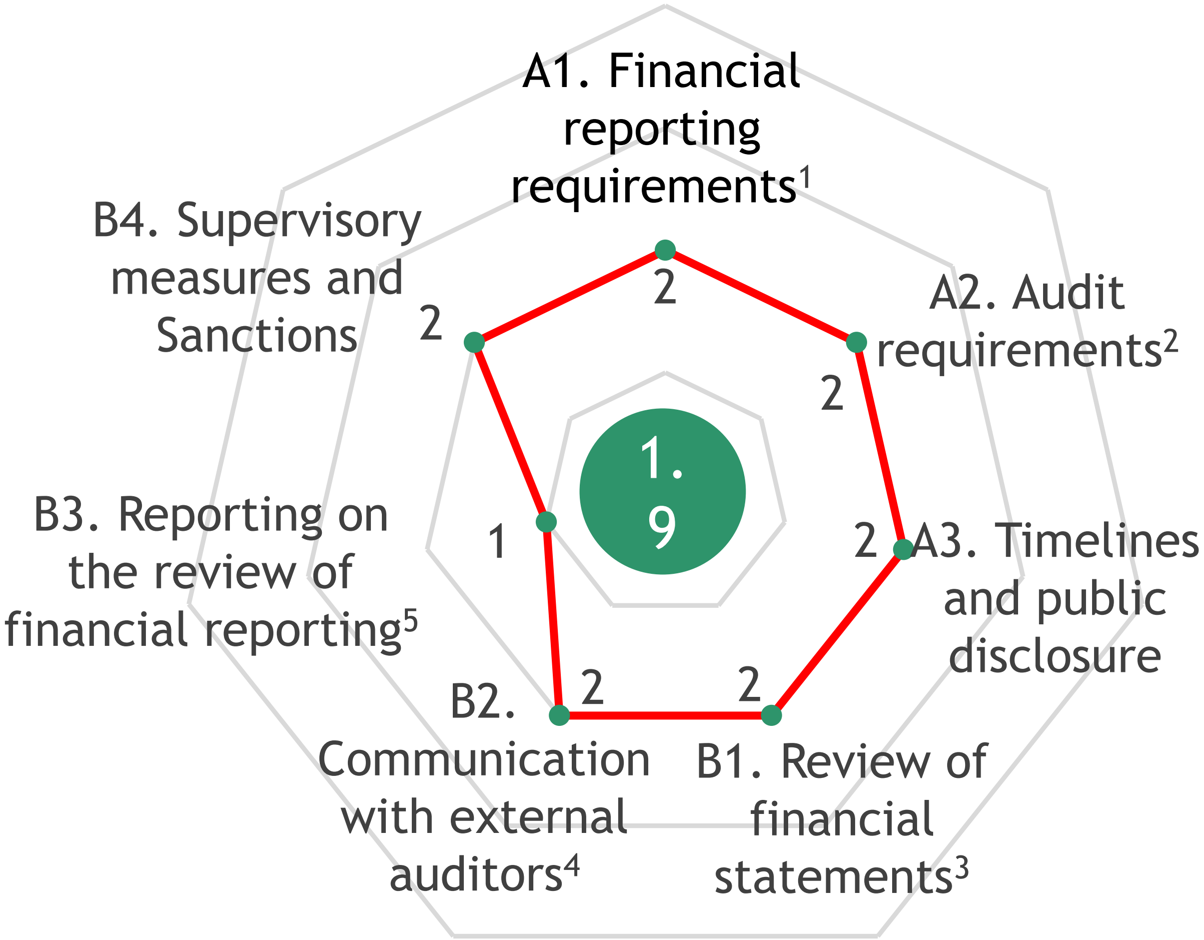
Aside from the common concerns raised above:

- Interim financial statements are not required to be reviewed by auditors
- There are no specific protocols in place for the regulator to hold meetings with the auditors, although regular meetings do take place
- The outcome of the reviews that are done are not publicly communicated

Corporate reporting

Insurance entities

Performance indicators



Comments

1. No requirement for interims or MD&A
2. No requirement for audit committees or MD&A
3. No dedicated function to review AFS for IFRS compliance
4. No specific requirements for regular meetings with auditors and or with directors and auditors
5. The regulator prepares an annual report, but does not include IFRS.

Key considerations - concerns

Aside from the common positives raised above:

- Quantity of reporting under IFRS is generally poorer then other sectors

Key considerations - concerns

Aside from the common concerns raised above:

- Interim financial statements are not required
- A public depository for financial statements exists but is not yet operational
- There are no specific protocols in place for the regulator to hold meetings with the auditors, although some meetings do take place
- The reviews of financial statements do not focus on IFRS compliance, and the outcome of the reviews that are done are not publicly communicated

Findings
Profession

Accounting profession

Performance indicators

- Unlike other ROSC indicators, the ratings in this section are based on the assessment of IFAC (Member Compliance Program)
- It therefore does not follow the same 4-point progression matrix
- Should none-the less be read in conjuncture with ROSC A&A report

Performance indicator	Rating
International education standards	Partially adopted
Code of ethics for professional accountants	Partially adopted
Investigative and disciplinary system	Not adopted

Audit oversight

Performance indicators

- The Law on audit activities, signed into law in late 2021 significantly improves the audit oversight function:
  - Establishes a three-tier professional qualification framework
  - Establishes a dedicated quality assurance process including:
    - Mandatory audits
    - The establishment of an independent audit oversight body
    - Requirements for mandatory inspections
    - Requirements for selection of inspectors
- However, as noted, at the time of finalising this report, (and as expected given short timelines), little work had been done to operationalise the law

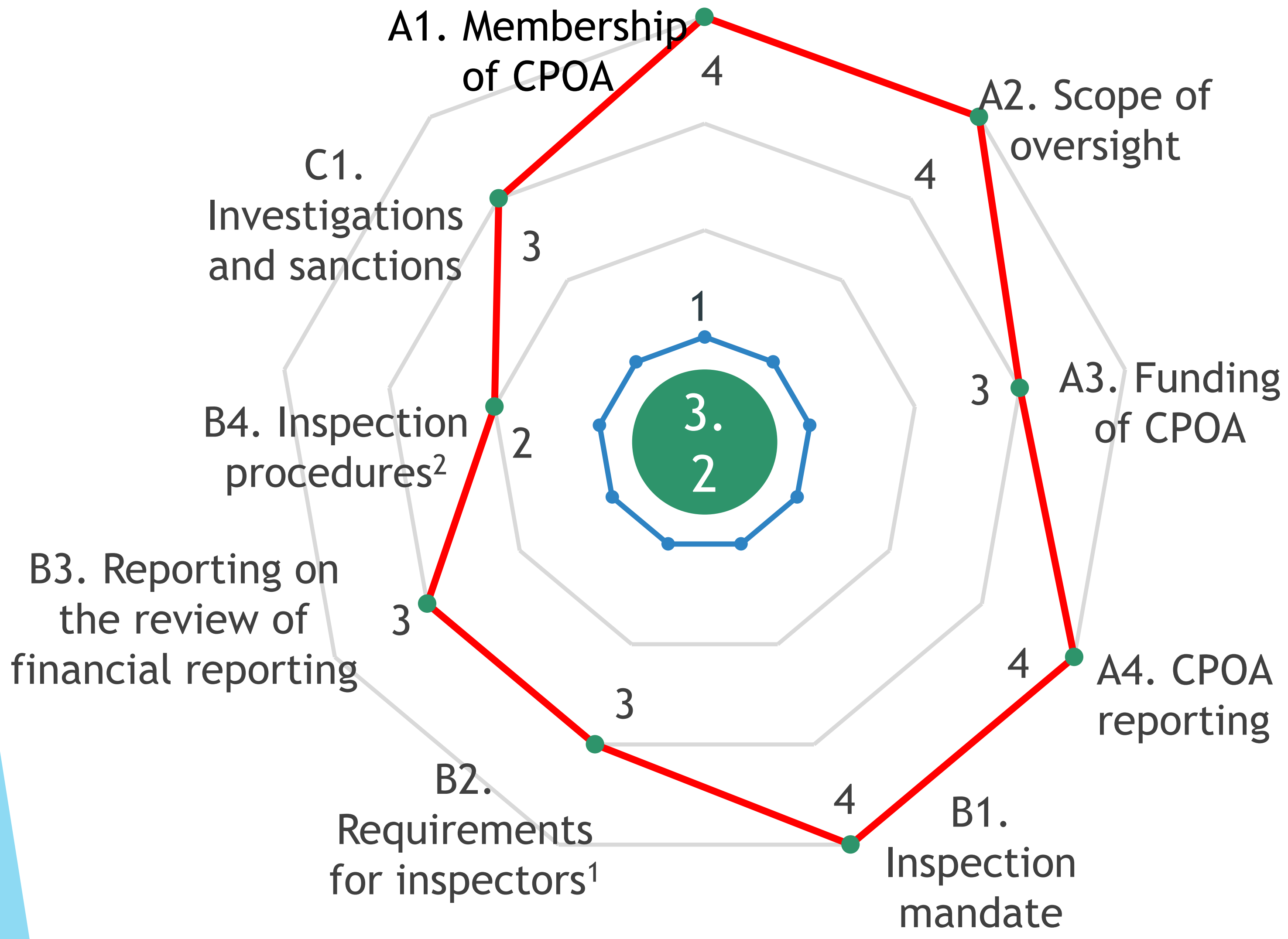
Audit oversight

Performance indicators

- As a consequence of the the existence of good legislation, but the absence of evidence of operationalisation, the report seeks to only evaluate the legislation
- Reviewers note however that previous legislation was poorly complied with, in part because of a moratorium on inspections

Audit oversight

Performance indicators



- Ratings based on the legal framework in the new law
- The new law was not operationalised at time of report, therefore operational rating is 1.

Comments

1. Reliant on external consultants, not clear that there will sufficient, qualified, independent capacity
2. Limited information available on actual procedures to be applied

Key overall considerations

- Strengthen regulatory and operational requirements to support legal framework
- Optimize regulators' monitoring to improve the quality of financial statements
- New challenges – Covid
- Implement a further simplified reporting requirement for some SMEs
- Implement CPOA for an effective audit oversight system
- Enhance existing one or more POAs to achieve an internationally recognized professional accounting body
- Improve accounting education in universities to provide the economy with competent resources

- Observed Practice

Reviews

- ROSC A&A process included reviews of financial statements and regulators' reports and discussions with stakeholders.
- Objectives are to
  - corroborate findings from assessments of accounting and auditing standards
  - gather perceptions on demand for and quality of financial information
- SRSFM and NBKR reports on reviews of financial statements are not published.
- Thus, assessment largely based on compliance reviews of financial statements, results of perception surveys, and discussions held with users

A risk-based approach to financial statements compliance review

- Boilerplate disclosures mask non-compliance: preparers use disclosure checklists and illustrative financial statements
- Thus, at superficial level disclosures often seem compliant
- However, appropriate judgements not necessarily being made
- Consequently, a tick-box disclosure-checklist financial statement compliance review is unlikely to be effective in assessing the quality of accounting and reporting
- Moreover, risk-based review likely will focus on more relevant issues by, for example, identifying and analyzing:
  - each entity's most significant judgements; and
  - selected issues currently of concern to regulators.

Compliance issues

Overall

- Observed financial reporting practices suggest significant gaps between the applicable legislative requirements and practice across all sectors
- Banking and microfinance sector generally appear to be significantly better than those other sectors reviewed
- Non-compliance with both financial reporting standards and filing requirements identified leading to limited availability of financial information in the market:
  - to support economic decision making and
  - to hold management to account for its decisions and actions

Compliance issues

Common issues

- Information available to public often limited to ‘primary financial statements’ with notes
- Poor organization and flow of financial statements with redundant information presented and boilerplate disclosures
- Omission of disclosure of significant judgments in applying accounting policies
- Omission or generic disclosure of key measurement assumptions
- Poor disclosure of events after the reporting period (eg effect of Covid 19)
- Depreciation policies are boilerplate and often inconsistent with IFRS requirements

Compliance issues

Common issues

- Insufficient disclosures about uncertain tax positions and recoverability of tax losses
- Poor disclosures of fair value measurement and risk management
- Related party disclosures omitted entirely, or inadequate
- It appears that some entities did not do impairment testing (in spite of the potential effect of the pandemic)

Corporate disclosure report analysis
overview and limitations

- Review involves an expert reading financial statements to assess the apparent quality of the financial reporting
- Review is not akin to an audit. Reviewer does not examine underlying evidence nor has access to management.
- In the time-constrained review, emphasis is placed on disclosures of particular judgements and estimates because:
  - doing so provides a risk-focus to the review (as disclosure of the most significant judgements and key measurement assumptions is required); and
  - experience from other jurisdictions indicates that professional accountants need to develop capacity to make judgements and estimates to apply a principle-based reporting framework.

Corporate disclosure report analysis
review methodology

- Understand: reviewers develop expectations about most important judgements they expect to find in the financial statements (so that they could focus their analysis on things that are different from what they expected to find)
  - understand the economic environment
  - understand current regulatory issues
  - understand the regulated entity
  - identify areas of focus
  - understand main judgements in accounting for areas of focus
- To the extent possible, analyse the identified significant judgements and entity’s disclosures about those judgements
- Conclude on findings and limitations of those findings

Corporate disclosure report analysis
three steps

Understand

Assess significant judgments

Conclude

Detailed Findings

SOEs

» All SOE financial statements reviewed likely did not comply with at least some aspects of IFRS in some key areas, even if the non-compliance presented itself in different ways.

» The external auditors of all SOE financial statements reviewed expressed qualified audit opinions covering multiple issues.

» Further indications of likely non-compliance with IFRS are observed by the reviewer in all SOE financial statements reviewed.

» All three (3) of the audit reports reviewed are qualified indicating failure to attain the minimum level of compliance with IFRS.

Listed companies

All non-financial institutions reviewed likely did not comply with at least some aspects of IFRS in some key areas, even if the non-compliance presented itself in different ways. Aside from the common issues:

- Incomplete disclosures of impairment of non-financial assets possibly impact the presentation of financial position.
- Possibly deficient financial asset impairment testing and incomplete credit risk disclosures
- Poor or non-existent going concern disclosures
- Questionable classifications
- Unrecognized assets and liabilities:

Financial institutions

The bank and microfinance sector financial statements reviewed generally appeared to be significantly better presented than those of the other sectors reviewed. Aside from the common issues:

- Deficiencies in disclosures about business models and financial instrument risk management.
- Possible deficiencies in loan loss provisioning
- Incomplete credit risk disclosures

Insurance companies

Both insurance companies reviewed likely did not comply with at least some aspects of IFRS in some key areas, even if the non-compliance presented itself in different ways. Aside from the common issues:

- External auditor’s report of one insurer’s financial statements was qualified
- Financial statements obviously incomplete, omitting comparative information and fundamentally important accounting policy and other disclosures
- Poor disclosures about insurance risk, credit risk, liquidity risk, and fair value measurement

Conclusions and next steps

Next steps

Final internal and external comments on report `

Publication of final report

Consideration of follow up steps and workshops

- Questions and Discussions