STATE UNITARY ENTERPRISE
“Khojagii Manziliyu Kommunali”

MANAGEMENT LETTER

based on results of audit of the consolidated financial
statements for the year ended December 31, 2020

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To Management of the State Unitary Enterprise “Khojagii Manziliyu Kommunali”

Dear Sirs and Madams,

In planning and performing our audit of the consolidated financial statements of the State Unitary Enterprise “Khojagii Manziliyu Kommunali” (the “parent Company”) and its subsidiaries (the “group”) for the year ended December 31, 2020 we considered the internal control structure in order to determine our audit procedures for the purposes of expressing an opinion on the consolidated financial statements, but not however to provide assurance on the internal control structure.

In connection therewith, we submit this report containing our comments, observations, and recommendations concerning the internal control structure and certain accounting, administrative and operating matters, which resulted from our audit of the Group’s financial statements for the year ended December 31, 2020. Definition of the expression “internal control structure” used in this letter is set in Appendix A.

This report is intended solely for the information and use of the World Group and Management of the State Unitary Enterprise “Khojagii Manziliyu Kommunali”.

We would like to thank the Management and personnel of the Group for their assistance and co-operation during the audit. We acknowledge that the Group has applied efforts to develop and strengthen its accounting, financial reporting, and internal control system.

We will be pleased to discuss these comments with you and, if desired, to assist you in implementing any of the suggestions.

Baker Tilly Klitou and Partners

INTREPRINDEREA CU CAPITAL STRAIN REPUBLICA MOLDOVA S.R.L. “BAKER TILLY KLITOU AND PARTNERS” IDNO 1007600043180

Baker Tilly Klitou and Partners SRL

Chisinau, the Republic of Moldova
December 6, 2021

STATE UNITARY ENTERPRISE "KHOJAGII MANZILIYU KOMMUNALI"

CONTENT

INTRODUCTION

This letter highlights our observations and recommendations we believe warrant the Group Management’s attention and would facilitate improved effectiveness and efficiency of the Group’s operations. Certain comments made relate to situations, which warrant immediate attention, while others relate to enhancements of policies and practices and should be addressed according to their perceived significance. The Management should prioritize the observations and implementation of the recommendations accordingly.

Although the Group has improved some of their internal control procedures, we still believe that there are certain areas where additional follow-ups are necessary. Included in this letter are a summary of our recommendations.

I. GENERAL RECOMMENDATIONS

1. Preparation of financial statements

Priority **High**

Observation

During performing our audit procedures at the stage of planning and reporting we have identified that current structure of the Accounting department does not include position of an accountant responsible for monitoring of recent amendments in International Financial Reporting Standards (the "IFRS") and compliance with internal requirements related to preparation of financial statements.

Besides, the Group does not prepare financial reports based on IFRS with disclosures of major accounts of the financial reports and descriptions of significant principles and regulations of the accounting policy.

Control over completeness and accuracy of preparation of financial statements is an important issue.

Recommendation

We recommend the management of the Group to draw attention on process of preparation of the financial statements, including, in particular, examination of recent amendments to IFRS, which is a basis for accounting activities in the Republic of Tajikistan. If necessary to arrange special trainings and seminars on recent amendments to IFRS, basic accounting principles and taxation of the Republic of Tajikistan for accounting personnel, in order to improve qualification of accounting personnel and ensure accurate and proper preparation of the financial statements.

We recommend preparing control checklist for verification of completeness and accuracy of financial statements in accordance with IFRS in order to take into account all details in preparing financial statements.

Management response

Recommendations taken into consideration.

2. Absence of internal policies and procedures

Priority **High**

Observation

During execution our audit procedures at the stage of understanding of business cycles which are critical for the Group's operations, we have identified absence of some critical descriptions of accounting policies and internal procedures.

Approved internal policies and procedures provide to employees of the Group clear guidance and instruction for conducting operations. Absence of such procedures might lead to different interpretation of the same operations by employees and inappropriate implementation of operations. All internal policies and procedures serve as guidance to the Group's personnel. They are designed to help ensure that management directives are properly carried out and all requirements are fulfilled. Procedures on financial reporting will help the Group's personnel understand how their activities in the financial reporting relate to the work of others.

We have also revealed that the Group does not have clear policies and procedures for making backups of accounting information on external disks, so that in case of emergency and loss of accounting data the information related to accounting could be restored with minimum efforts and losses.

In addition, storage of supporting documents is not structured. This fact may lead to risks of loss and inaccuracies of data in the accounting process.

Recommendation

We recommend the Group to develop properly designed accounting policy and internal procedures on significant transactions, with taking into consideration the best practices used in the provision of water services, where appropriate procedures, policies, job descriptions with reference to IFRS and the applicable legislation will be described.

We also recommend on a periodic basis, but not less than once a month, to make backup electronic copies of general ledger and material reports prepared in paper form, for use in the event of damage.

Management of the Group should consider importance of accounting documentation archiving procedures, including structuring by nature, type of transactions and chronological order.

Management response

Recommendations taken into consideration.

3. Fraud risk questionnaires

Priority **High**

Observation

During our audit procedures, the Group did not provide us the questionnaires on risk of fraud, filled by Chairman of the Group, Head of Legal department and Head of Internal Control Department.

The process of completion the questionnaires on risk of fraud is an important part of audit process and allows to evaluate internal control structure of the Group, issues during audited period and the possible effect on the financial statements.

Recommendation

We recommend management of the Group to respond to the requests of the auditors in timely manner, as this practice is standard audit procedure according to International Standards on Auditing.

Management response

Recommendations taken into consideration.

4. Subsequent events

Priority **High**

Observation

During the audit procedures on the stage of substantive testing the Group did not provide us access to the information for 2021. We were unable to obtain sufficient and appropriate audit evidence to identify whether adjustments and disclosures in the consolidated financial statements are necessary according to IAS 10 Events after the reporting date.

The events rather favorable or unfavorable which occur between the end of the reporting period and the date of approval the financial statements for issue were not indicated in the financial statements of the Group.

Refusal for providing this information may affect the accuracy of the financial statements and can impact audit opinion.

Recommendation

We recommend management of the Group to provide all required information for preparation of financial statements to comply with IFRS and always consider events after the reporting period for this purpose.

Management response

Recommendations taken into consideration.

5. Offsetting of financial assets and financial liabilities

Priority **High**

Observation

During audit procedures on the stage of testing of accounts receivable and accounts payable, we found that the Group at the end of the reporting period does not make offsets of receivables and payables under contracts with the same counterparty.

In accordance with IAS 32 "Financial Instruments: Presentation" – "*A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity currently has a legally enforceable right to set off the recognised amounts; and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously"*.

This practice can lead to an overstatement of accounts receivable and payable, incorrect accrual of allowance for doubtful debts and incorrect exchange losses, which in turn can lead to a distortion of the consolidated financial statements.

Recommendation

We recommend the Group to offset financial assets and financial liabilities which meet the requirements of IAS 32 "Financial Instruments: Presentation".

Management response

Recommendations taken into consideration.

6. Fixed assets depreciation rates

Priority **High**

Observation

During audit procedures on fixed assets testing we identified unreasonably understated or overstated depreciation rates on certain fixed assets in accounting system of the Group.

This fact can lead to unreasonable accrual of depreciation expenses for the year and accumulated depreciation of fixed assets.

Fixed Assets comprise a significant portion of the Group's assets and this practice might lead to the omission of timely error detection and to significant distortion of the consolidated financial statements of the Group.

IAS 16 "Property, plant and equipment" requires reviewing reasonableness of the depreciation rates on an annual basis and reflecting the consumption benefit of using fixed assets.

Recommendation

We recommend the Management of the Group to pay special attention to accounting of fixed assets, particularly:

1) Revise the depreciation rates and test accounting system for the presence of incorrect depreciation rates;

2) Introduce control over calculation of depreciation of fixed assets by recalculation on sample basis of several positions.

Management response

Recommendations taken into consideration.

7. Revaluation of fixed assets

Priority **High**

Observation

The Group did not revalue its fixed assets and did not conduct a test for impairment of assets.

Given that the Group has not revaluated the building for a long time, we believe that the fair market value of the building may differ significantly from the value for which the building is accounted by the Group.

The foregoing facts may lead to a material misstatement of the information presented in the Group's consolidated financial statements.

Recommendation

We recommend the Management of the Group to conduct revaluation of fixed assets to fair value in full compliance with the International Financial Reporting Standards (the "IFRS").

In addition we recommend performing regular independent revaluation for fixed assets accounted at fair value, particularly, "Building and constructions" category, if there are indicators that show changes in the fair value of these assets but not less than every 5 years.

Management response

Recommendations taken into consideration.

8. Accrual method in recognition of operating expenses

Priority **High**

Observation

During the testing of the insurance expenses, as a part of operating expenses, we have identified that the Group has recognized them on the cash basis.

One of the basic principles of preparation of the financial statements in accordance with IFRS is the accrual basis, under which income and expenses are recognized in the financial statements at the time when service is rendered rather than at the time of payment or receipt of funds.

Accrual method is the one of the basic principles of IFRS. As it is stated in IAS 1 “Presentation of financial statements”: “…*in accordance with this method results of operations and other events are recognized as they arise (not when funds were received or paid), they are recorded in accounting registers and reflected in financial reports in the periods to which they relate”.*

Cash basis of accounting for the recognition of income and expenses is unacceptable for financial statements issued in accordance with IFRS.

Recommendation

We recommend the Management of the Group in order to comply with requirement of IFRS and preparation reliable financial statements recognize expenses in the period to which they relate, and also apply accrual basis for recognition of expenses related to services received.

Management response

Recommendations taken into consideration.

9. Document processes and controls.

Priority **High**

Observation

The Group does not have documented processes and controls, covering the following accounting routines

- Accounting and financial statement close process.
- Overseas entities reporting.
- Sales and accounts receivable
- Cash disbursements
- Payroll
- Provisions and accruals
- Taxation and etc.

Lack of documentation of these processes may lead to inconsistencies and ambiguity across processes and reporting departments or entities. Similar activities may be performed in a different manner and to unclear deadlines, creating difficulties if an alternative performer of the activity is required. This lack of documentation and process may also lead to inefficiencies in the monthly and annual close processes.

Recommendation

Management should document its processes and controls and as part of this documentation exercise, standardize its process protocols where it makes sense to do so. This will help to establish clear accountability and segregation of duties and will set out authority and responsibility over the initiation, authorization and processing of transactions. Documenting processes also provides an opportunity to review procedures and to introduce efficiencies or improve controls, as well as to provide support for future growth.

We recommend to the Management of the Group to prepare and develop designed policy and procedures to regulate main activities of the Group.

Management response

Recommendations taken into consideration.

10. Improve of consolidation process.

Priority **High**

Observation

The Group's corporate structure includes multiple entities which each have individual general ledgers; however, the accounting system is not capable of consolidating the individual trial balances automatically. The Group uses an excel spreadsheet for purposes of consolidation. There is minimal documentation over the consolidation entries and a lack of evidence of review of the consolidation. This manual consolidation process increases the risk of error as data is manually extracted from the system and formatted to the excel template.

Also the Group unable to obtain individual trial balances and other breakdowns of some of its subsidiaries.

The Group should review the consolidation process and consider automating the process by investing in a consolidation report or software package add-on to improve the efficiency of the internal consolidated reporting. Additionally, the Group should clearly document all consolidation entries with supporting back-up. Management should review both the monthly consolidation entries and the consolidation schedule on a timely basis.

Recommendation

We recommend to the Management of the Group to review the consolidation process and consider automating the process by investing in a consolidation report or software package add-on to improve the efficiency of the internal consolidated reporting. Additionally, the Group should clearly document all consolidation entries with supporting back-up. Management should review both the monthly consolidation entries and the consolidation schedule on a timely basis.

Management response

Recommendations taken into consideration.

11. Review transactions on a timely basis.

Priority **High**

Observation

There were several transactions in the year that were not appropriately analyzed by management.

Due to the lack of control and inappropriate recognition of transactions and the analysis, relevant facts were more difficult to accumulate, which caused a delay in the annual financial reporting process and completion of the audit.

Recommendation

We recommend to the Management of the Group to analyze and document conclusions relating to transactions as they occur throughout the year in order to ensure that they are properly accounted for during the year.

Management response

Recommendations taken into consideration.

12. Reconcile intergroup balances

Priority **High**

Observation

The Group does not reconcile its accounts with other group companies on a regular basis. This resulted in significant delays in the preparation of the consolidated financial statements as a number of disputes arose when reconciling the year-end balances.

Intergroup accounts should be reconciled on a regular basis, at least quarterly, in addition to the year-end reconciliation process. More routine reconciliation will avoid any unexpected adjustments as discrepancies can be resolved in a timely fashion. Additionally, it will provide more accurate and reliable financial reporting throughout the year.

Recommendation

We recommend to the Management of the Group to reconcily intergroup balances on a regular basis, in order to avoid any unexpected adjustments as discrepancies can be resolved in a timely fashion.

Management response

Recommendations taken into consideration.

13. Accounting system

Priority **High**

Observation

During reviewing the main business activities of the Group, we have identified that the automated accounting system's facility is unable to fully consolidate and automate the procedures of preparation, formation and presentation of financial statements.

Consolitated accounting of all business operations, accrual and posting of all calculations in the system, including depreciation charge and other accruals, allow the Group to control all financial and operational indicators; inspecting both correctness and completeness of business operations, significantly simplify the preparation process of financial statements and calculation of tax liabilities.

Recommendation

We recommend the Management of the Group to develop the accounting system and insure other technical and organizational conditions for efficient work of the accounting system.

Management response

Recommendations taken into consideration.

14. Reconciliation acts with debtors and creditors

Priority **High**

Observation

During our audit we have identified that the Group does not prepare reconciliation acts with debtors and creditors with significant outstanding balances as of reporting dates. Lack of reconciliation acts as of reporting dates with counterparties with material balances may lead to risk of misstatements in the receivable and payable balances.

Lack of strict system of internal controls in accounts payable and accounts receivable may lead to serious problems, since both receivables and payables are very important in determining financial position of the Group.

Recommendation

We recommend management of the Group to prepare reconciliations of receivables and payables at least once a quarter to assure that the balance are properly recorded in the financial statements and resolve possible litigations with third parties.

Management response

Recommendations taken into consideration.

15. Prepare of stock count act on reporting periods.

Priority **High**

Observation

During performing substantive procedures, we have noted that as of the reporting date the Group provided us with stock count report without any clarification and conclusion about write offs, conditions, and factual quantity of the stock. Moreover, as part of the documentation there was no order and composition of the inventory commission. Need to pay attention to the fact that the Client do not pay sufficient attention to the process of stock count.

Stock count is one of the key and most effective procedures in internal controls system for any entity. This procedure is vital for timely determination of assets quantity, reconciliation of assets with balances in accounting books, checking of physical condition of assets and prevention of assets losses.

Recommendation

We recommend management of the Group to maintain strictly control over stock count process and perform stock counts as such need arises, but not less than once a year, so that the amounts could be reconciled with accounting records as at the reporting dates.

Management response

Recommendations taken into consideration.

16. Prepare of cash count act and bank reconciliations on a timely basis.

Priority **High**

Observation

The Group does not prepare cash count act for the reporting period and bank reconciliations on a regular or timely basis, which may allow errors or fraud related to cash to go undetected.

Cash count act and bank reconciliations should be prepared at least at the end of the year. Reconciliations should be reviewed by a person independent of the reconciliation process.

Recommendation

We recommend management of the Group to maintain strictly control over cash balances and prepare bank reconciliations monthly or at least one time in a year.

Management response

Recommendations taken into consideration.

17. Accounting for transactions with related parties

Priority **High**

Observation

During implementing audit procedures on related party transactions, we have identified that the Group does not have any policies and regulations regarding disclosure of related party transactions as required by IAS 24 “Related party disclosures”:

“The relationship between related parties may have an effect on profit and loss, also on the financial position and results of the Group. Related parties may have transactions which cannot be executed with a non-related party”.

“For these reasons, the presence of the information of related party transactions, outstanding balances and relationships between them, could affect the evaluation of the operations of the Group by the users of financial statements, including risk assessment and opportunities faced by the Group”.

We were unable to obtain sufficient and appropriate audit evidence to identify related party relationships, transactions and balances that qualify for disclosure under IAS 24 “Related party disclosures”.

The absence of complete and comprehensive data on transactions with related parties can lead to incomplete presentation of information in the financial statements.

Recommendation

We recommend the management of the Group to develop regulations on accounting for transactions with related parties in accordance with requirements of IAS 24 “Related party disclosures”.

We recommend developing a guide for employees of the financial department on preparation of information for identification of transactions with related parties for management and other stakeholders.

Management response

Recommendations taken into consideration.

18. Unused vacation provision

Priority **High**

Observation

During execution of audit procedures on payroll business cycle we identified that Group does not accrue allowance for unused vacation at the reporting dates. According to IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" (hereinafter "IAS 37") Group should accrue provision for probable future obligations taken from work practice or legal obligations.

According to the Labor Code of the Republic of Tajikistan and the internal policies of the Group, each employee should be allowed an annual leave. If the employee does not take annual leave, the Group has an obligation to make payment of the amount of the average rate of wages for the past months.

The absence of written procedures and practices on accrual of allowance of unused vacation, control and methodology of unused vacation calculation at the end of the year may lead to understatement of obligations of the Group and untimely recognition of unused vacation expenses, as a result, to distortion of financial statements.

Recommendation

We recommend the management of the Group to develop and implement accounting procedures to accrue allowance for unused vacation of the Group’s employees at the reporting dates, proceeding unused vacation days as at December 31 of each year.

Management response

Recommendations taken into consideration.

19. Calculation of deferred income tax

Priority **High**

Observation

During the audit of deferred income taxes as at reporting date, we have identified that the Group did not calculate deferred income tax.

According to IAS 12 “Income taxes”, all temporary differences should be considered in the same period as period of calculation of tax base for income tax. As minimum the following temporary differences should be considered during calculation of deferred taxes:

1. Unused vacation provision;
2. The difference in net book value of fixed assets and intangible assets calculated for accounting and tax purposes;
3. Allowance for doubtful accounts receivable;
4. Temporary difference on accounts payable;
5. Temporary difference on interest payable from loans received;

These temporary differences may influence, individually or cumulatively the financial statements of the Group concerning income tax during the period and financial performance of the Group. Also, it should be taken into consideration that effect of deferred taxes is recognized in the statement of changes in equity or in the statement of profit or loss and other comprehensive income based on the nature of related temporary differences.

Recommendation

We recommend the Management of the Group to supplement the accounting policies with a section, provided definition and calculation of temporary differences between the tax and financial accounting in accordance with IAS 12 “Income taxes” and keep a record of deferred tax assets / liabilities in accordance with this policy.

Management response

Recommendations taken into consideration.

20. Implementation of IFRS 9

Priority **High**

Observation

In 2014 the International Accounting Standards Board replaced IAS 39 "Financial Instruments: Recognition and Measurement" by issuing a new standard IFRS 9 "Financial Instruments" which contains updated requirements for the recognition and measurement of financial instruments and requirements for hedge accounting. The new standard is effective starting from January 1, 2018.

Most significant changes were introduced to classification and measurement of financial assets. IFRS 9 introduces new impairment model that is based on expected losses (rather than incurred losses model in accordance with IAS 39) and provides for wider scope of application in comparison with IAS 39.

General approach implies that expected credit losses to be recognized for losses equal to the expected credit losses within 12 months after the reporting date and expected credit losses throughout the whole period of the financial instrument.

These amendments might lead to significant increase of expected credit losses allowance at the date of application and require development of financial model (based on both historical and forecasted data) in order to determine the expected credit losses on financial instruments

Recommendation

We recommend management of the Group to consider importance of these amendments and to take sufficient and timely measures to prepare for the transition to IFRS 9.

In addition, existing accounting documents (accounting policy, procedures for impairment, etc.) should be substantially updated considering all requirements of the new standard.

Development of financial model for expected credit losses estimation will require preparation and processing significant volume of historical data, macro prognosis, personnel efforts, maintenance of the system and supervision by the Group's management.

Management response

Recommendations taken into consideration.

APPENDIX A

Responsibility of the Management, purposes and limitations inherent in the internal control structure

The following comments regarding responsibility of the management for the internal control structure, purposes and limitations inherent in the internal control structure are based on the International Standards on Auditing issued by the International Federation of Accountants through the International Auditing and Assurance Standards Board.

Responsibility of the Management

The Management is responsible for development and ensuring operation of the internal control. Meeting this objective requires the Management to make forecasts and estimates to determine the expected gain and costs relating to fulfillment of the policies and procedures of internal control.

Purposes

The purposes of internal control over financial statements consist in provision of the Management with sufficient but not absolute certainty in security of assets and protection from losses as a result of unauthorized use or distribution of assets and guarantee of conduct of operations on the basis of orders of the Management and their proper accounting, which will ensure preparation of financial statements under International Financial Reporting Standards.

Limitations

Due to limitations inherent in any internal control structure, there is a possibility of mistakes and inaccuracies, which can remain undetected. Besides, forecasts with regard to any assessment or structure applicable to future periods can lose their significance due to changed conditions or decreased efficiency of the structure and functionality of the policies and procedures.