Expert opinion on KPMG's application of ISA 560 in auditing Kazpolmunay LLP, Tolkynneftegaz LLP and Tristan Oil Ltd for the financial years 2007, 2008 and 2009

dispute between

Republic of Kazakhstan

and

Anatolie Stati, Gabriel Stati, Terra Raf Trans Traiding Ltd and Ascom Group S.A

25 November 2019

TERMS AND ABBREVIATIONS

BDO Appendix	Appendices to this report
Assurance engagements	An engagement in which the auditor aims to obtain sufficient and appropriate evidence to be able to submit a statement designed to enhance the degree of confidence of the intended users other than the responsible party regarding the results of measurements or valuation of an underlying review object against criteria.
Stati et al.	Anatolie Stati, Gabriel Stati, Terra Raf Trans Traidning Ltd and Ascom Group S.A.
HSF	Herbert Smith Freehills Germany LLP
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
ISQC 1	Quality control for audit firms that perform audit and review of financial reports as well as other Assurance engagements and related services.
Kazakhstan	Republic of Kazakhstan
KPMG	KPMG Audit LLC
MSA	Mannheimer Swartling Law Firm Aktiebolag

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1. INTRODUCTION

1.1 A brief description of the dispute

1 On December 19, 2013, an arbitral award was rendered in SCC Case No. V (2010/116) between, on the one hand, Anatolie Stati, Gabriel Stati, Terra Raf Trans Traiding Ltd and Ascom Group S.A. ("Stati et al.") and, on the other hand, the Republic of Kazakhstan ("Kazakhstan"). The arbitral award ordered that Kazakhstan pay damages of approximately USD 497 million to Stati et al.

2 Kazakhstan has unsuccessfully challenged and moved to invalidate the arbitral award before the Svea Court of Appeal, which rendered a judgment on December 9, 2016. In the Court of Appeal's judgment, Kazakhstan's requests that the Court of Appeal set aside or invalidate the arbitral award were denied.

3 Since the arbitral award was rendered, Stati et al. have tried to enforce it in several countries. Kazakhstan's counsel has informed BDO that in the time following the arbitral award, Kazakhstan has obtained evidence that Kazakhstan lacked access to during the arbitration and during the subsequent case before the Court of Appeal.

4 Among other things, Kazakhstan, through its legal counsel, has received a letter (appendix 9) from the audit firm KPMG in which KPMG takes measures to prevent anyone from relying on the reports submitted for the financial years 2007, 2008 and 2009 regarding the companies Kazpolmunay LLP, Tolkynneftegaz LLP and Tristan Oil Ltd.

5 KPMGs letter to Stati dated February 15, 2016 (appendix 2) gives a view of the supporting evidence that KPMG received as of 2015 that made KPMG request an explanation from Stati in relation to the construction of an LPG Plant in Kazakhstan by Tolkynneftegaz LLP during 2007 – 2009. The LPG plant never entered into operation since the construction was discontinued in early 2009 when the plant was next to completion. The main components for the plant were supplied by TGE Gas GmbH at a cost of approx. USD 34million. According to KPMG the total cost for the construction of the plant amounted to USD 248 084 133 for the year ended 31 December 2009. At least a part of the cost for the construction of the LPG plant was charged from a company called Perkwood Investment Ltd (“Perkwood”). Perkwood was according to the new information KPMG received, a related party to Ascom Group and it was not an operating company. The company’s accounts also showed that it was a dormant company.

6 Perkwood reportedly invoiced management fees of USD 43 852 108. This is a material amount from a company that was reportedly dormant. In addition, KPMG wanted Stati to provide supporting evidence regarding any material difference in cost for the LPG Plant charge from Perkwood to Tolkynneftegaz LLP compared to those actually charged by TGE Gas GmbH the ultimate supplier of the equipment. As KPMG states in the letter dated February 15, 2016, management fees and other cost that are not necessary for the construction of the LPG plant should be (according to IFRS) accounted as dividends. Recognition of part of the construction cost as dividends would reduce the book value of the LPG Plant.

7 The information KPMG received forced them to request explanations from Stati, explanations, that Stati never provided (See attachment 2 – 4 and 6 – 11 for correspondence). The lack of explanations subsequently leads to KPMG submitting its letter to Stati dated August 21, 2019

1.2 Qualifications

8 This report has been written and produced by Mats Jakobsson, Authorized Public Accountant and Partner at BDO. Mats has many years of experience in auditing in most industries and is one of BDO's foremost experts in accounting, both under international and Swedish regulations.

9 Mats has been appointed as an expert on many previous occasions and has solid experience in rendering expert opinions in both court and arbitration proceedings. For further information on relevant professional experience, CV is attached as Appendix 1.

1.3 Independence and conflict checks

10 BDO have performed a conflict of interest check. There have been no reported circumstances which in any way could be perceived as affecting our independence with respect to the assignment BDO have received from Kazakhstan's legal counsel Herbert Smith Freehills Germany LLP ("HSF").

1.4 The purpose of the report

11 This report is only intended to be used in the dispute between Kazakhstan and Stati et al. It may not be used, by the parties to the dispute or anyone else, in any other context. The report does not constitute counseling and cannot establish advisory responsibility for BDO. Nor does BDO's report constitute an audit.

1.5 Report Structure

12 This report is structured as follows:

Chapter 2:	Description of the assignment
Chapter 3:	International framework for Assurance engagements
Chapter 4:	KPMG's letter dated August 21, 2019
Chapter 5:	Conclusion
Chapter 6:	Appendix list

2. DESCRIPTION OF THE ASSIGNMENT

2.1 Scope of the assignment

13 BDO have, by HSF, for its client Kazakhstan, been given the assignment of writing, as an expert, a report in which BDO briefly describe:

- the framework that an international accounting firm needs to relate to in order to revoke a submitted audit report and
- effect from an auditor's perspective of KPMG's letter dated August 21, 2019 with reference to audit reports submitted for annual reports and interim reports for the years 2007, 2008 and 2009 for the companies Kazpolumunay LLP, Tolkynneftegaz LLP and Tristan Oil Ltd.

2.2 Limitations of the assignment

14 BDO do not intend to make any assessment of the facts in this opinion, although BDO will comment on certain circumstances. By fact, BDO mean, for example the factual circumstances that form the basis of KPMG's decision to deliver its letter dated August 21, 2019.

2.3 Support for the assignment

15 This report is based on information from the following sources:

• Appendix 2-19

3. INTERNATIONAL FRAMEWORK FOR ASSURANCE ENGAGEMENTS

3.1 Introduction

16 Auditing is an assurance engagement where an auditor or audit firm aims to obtain sufficient and appropriate evidence to be able to issue a statement on whether a financial report has been prepared in accordance with the applicable financial reporting framework. If not, it must be stated in the audit report. The audit report is issued with the aim of increasing the level of confidence of intended users of the financial report other than the responsible party.

17 Before an auditor can accept an assurance engagement, the auditor needs to ensure that the conditions for performing the assurance engagement are met. For the conditions for an assurance engagement to be met, the assignment must have the following characteristics:

I. The underlying subject matter must be appropriate.

II. The criteria to be used for the preparation of the audit object must be appropriate in view of the circumstances of the assignment (an example of criteria that is appropriate is that the financial statements should be prepared in accordance with IFRS).

III. The criteria to be applied when establishing need to be available to the intended users.

IV. The auditor should expect to be able to obtain the evidence needed to support the auditor's conclusion.

V. The auditor's statement when submitting an audit report is formulated in such a way that the statement is made with reasonable assurance.

18 In order to provide guidance on audit assignments and enhance the degree of confidence of the intended users, International Standards on Auditing (ISA) exist. ISA can be divided into different categories where 200 - 299 refers to the auditor's duties and responsibilities, 300 - 499 Planning and internal control, 500 - 599 Audit evidence, 600 - 699 Use of other people's work and 700 - 799 conclusions and reporting. If an international accounting firm chooses to submit a statement in accordance with ISA, this means that all relevant ISAs should be applicable to the audit.

19 In addition to the ISA, which for an auditor need to apply in the audit, there is also ISQC 1 "Quality control for audit firms that perform audit and review of financial reports and other assurance engagements and related services" ("ISQC 1"). ISQC 1 aims to ensure that an audit firm has a system for quality control of the audit as well as other assurance engagements and related services. The requirements of ISQC 1 mean that it will be necessary for an international audit firm to build a quality system that includes all companies that are part of the network. This is due to the fact that many assurance engagements extend over several countries, which results in auditors from several countries taking part of the audit. The only way to ensure quality in the audit is to introduce a quality system that covers all companies in the network.

3.2 Additions to ISA and differences between countries

20 ISA are primarily prepared for the auditor's audit of financial reports but can also be used for review of other information. ISA do not deal with the responsibility that an auditor may have due to legislation in the country where the auditor operates. As an example, Sweden is relatively unique in the sense that, according to the Swedish Companies Act (SFS 2005: 551), the auditor is obliged to express an opinion on the management of a company. Nor is it generally natural in other countries for the auditor to express an opinion in the audit report about whether a company pays and reports taxes correctly.

21 It should be borne in mind in a Swedish comparison that in most countries there is no audit obligation, which means that auditing normally only occurs in the companies where there is a large general interest or scattered ownership. Smaller companies generally do not have audits in these countries in accordance with the standard required by ISA to the same extent as in Sweden.

22 ISA's starting point is to regulate how the financial audit is to be carried out, but it is often supplemented by legislation in different countries, which is then imposed in addition to what ISA state and which can differ. It means, for example, that ISA does not include the Swedish requirement for the auditor to report certain types of crimes in limited companies, if suspicion arises, to prosecutors.

23 Since ISA assume that the auditor complies with professional ethical rules that include, among other things, a duty of confidentiality, an auditor in different countries does not have the same means of pressure in cases where an auditor notes errors in his audit. According to ISA, the opportunity the auditor has for expressing his opinion is limited to the extent to which the audited object (eg a financial report) has been prepared in accordance with the stated framework (eg IFRS) or not. Errors and deficiencies of a company that the auditor is aware of that do not affect the financial report that the auditor should express an opinion on does not affect an Audit Report in accordance with the requirements of ISA.

3.3 Auditor's actions after submission of report (ISA 560 Subsequent events)

24 ISA 560 Subsequent events ("ISA 560") provide guidance on how an auditor should act when the auditor becomes aware of facts after the auditor submits its report. The auditor has no obligation to perform any audit procedures regarding the financial statement after the date of the auditor’s report, but still needs to act in the event that the auditor receives facts that, had they been known to the auditor at the date of the auditor’s report, would have caused the auditor to amend the auditor’s report.

25 Again, the auditor needs to take into account the rules that apply in the country in which the report was issued. In cases where the auditor becomes aware of the facts before the financial report is issued, the auditor shall discuss the issue with the management and, where applicable, with the board. The purpose of the discussion is to determine whether the financial reports must be changed and how the management intends to handle the change. In cases where the company changes the financial report, the auditor needs to expand its audit to take into account the circumstances that caused the change before the auditor can submit its report.

26 In cases where the management does not want to change the financial report or laws in some jurisdictions do not allow the management to change the financial report, if the report has not yet been submitted, the auditor should change its report and modify the statement before submitting it. If the report has already been submitted to the management or the board, the auditor must inform that this report shall not be issued to an external party before the necessary changes have been made. If the financial statements are subsequently issued without the necessary changes, the auditor shall take appropriate measures to try to prevent anyone from relying on the report submitted by the auditor.

27 ISA 560 provides guidance on how the auditor should act in cases where the auditor becomes aware of facts after the financial statements have been issued. Since the auditor has no obligation to carry out any further review after the submission of an audit report, new facts usually emerge in connection with the review of the coming years or the review of an interim report. In Sweden, earlier annual reports that are registered by the Swedish Companies Registration Office are generally not amended. In other countries where the requirements for registration are not the same, there is the possibility of retroactively adjusting the annual report. In cases where it is possible to correct a financial report, ISA 560 places the same requirements on the auditor as in the cases where the financial report has not yet been issued.

28 In Sweden, the auditor has various possilites to ensure that information that the previously submitted financial report and the auditor's report have been incorrect reaches the relevant stakeholders. On the one hand, there are legal requirements that require the auditor to report conditions that are extremely serious. As mentioned above, it is generally common for errors attributable to previous periods to be noted in connection with regular review of interim reports or review of future financial reports. In cases where the financial reports that are prepared do not include enough information about the errors that have become known, the auditor has the opportunity in its report to inform stakeholders about the errors that have occurred. This opportunity for information generally means that the companies themselves choose to inform stakeholders about the errors that have occurred.

29 An auditor in Sweden have the possibility to resign from the engagement if the board chooses not to act in such a way that the information becomes known about the errors in the financial reports that have been submitted. In the event an auditor resigns the assignment prematurely, the auditor must, pursuant to the Swedish Companies Act Chapter 9, section 23 immediately report this for registration. A copy of the notification must also be submitted to the company's board of directors. In the notification, the auditor must also “provide an account of what he or she has found in the audit he or she has performed during the part of the current financial year covered by the assignment.” This means that in cases where an auditor becomes aware of facts that cause a need to inform stakeholders about errors in previous financial reports, there is a natural way for the auditor to take appropriate action to ensure that no one relies on the auditor's previously submitted report. This is by canceling the assignment prematurely. In countries where there is no audit obligation, this possibility does not generally exist, which means that the auditor needs to find other ways to ensure that no stakeholder relies on previously submitted reports from the auditor.

30 Because there are possible means of pressure for an auditor in Sweden to ensure that material information about errors that appear in a financial report is known, it is extremely

unusual for an audit firm to publish information that previously submitted reports cannot be relied upon. In countries where the conditions are not the same as in Sweden, ISA 560 p 17 states that in cases where the company management or the board, despite being informed about the errors, does not take the necessary measures, "the auditor shall take appropriate measures to try to prevent anyone from relying on the auditor's report. "As stated in item A 20 for the application of ISA 560", the auditor's course of action depends in part on the rights and obligations he or she has. Accordingly, the auditor may consider it appropriate to seek legal advice." As can be seen from the correspondence that has taken place between KPMG and representatives of Stati, the auditor's role when errors arise is generally difficult to handle in cases where the company itself does not contribute to rectification. If the auditor fails to act, he or she risks an external party relying on the submitted audit report, which may result in damages for which the audit firm may be liable, at the same time, as is evident from Anatolie Stati's letter dated February 26, 2016, the audit firm also risk a claim for damages from the client. The client can, of course, also be considered to be liable for damage if the audit firm incorrectly takes actions to prevent reliance on the auditor's report.

4. KPMG's letter dated August 21, 2019

31 BDO have read the letter KPMG sent on August 21, 2019 to HSF, to the attention of Dr Patricia Nacimiento, partner at HSF. BDO have also taken note of the letter from KPMG sent on the same day to Anatolie Stati. From the letters, BDO can read that KPMG has received documents from Dr Nacimiento, which BDO interpret as KPMG having obtained new facts which the auditors need to consider in accordance with the requirements set forth in ISA 560.

32 KPMG has subsequently assessed the obtained facts in accordance with the requirements of ISA 560 and assessed how the new information affects the accuracy of the reports it has submitted regarding the financial reports submitted by Kazpolmunay, Tolkynneftegaz and Tristan Oil. By the letters KPMG has sent to Mr. Anatolie Stati and Ascom group S.A., KPMG has subsequently attempted to obtain their view of the facts KPMG obtained from Ms Nacimiento and other sources. By letter dated October 3, 2019 (appendix 18) KPMG informs Stati that "*..we have received no substantive response to the allegations we reported to you… (indeed, we note that you have made no effort at all to deny these.)*" KPMG therefore explicitly uphold their August 21, 2019 letter.

33 Considering the requirements placed on an auditor in accordance with ISA 560 p 17, KPMG has made the assessment that the facts it has received mean that the financial reports need to be changed. If KPMG had access to the information when it submitted its initial reports, it would have resulted in KPMG having to disclose the errors in its reports. The conclusion that KPMG draws thus becomes that it needs to take steps to prevent reliance on the auditor's reports.

34 In this case, it should be noted that the annual reports and the interim reports have been prepared for the financial years 2007, 2008 and 2009. For normal companies, no one generally relies on annual reports that old. The confidence that someone seeks for a company is generally based on the most recently submitted annual report that shows the most up-to-date information. In this dispute between Kazakhstan and Stati et al. However, the annual reports still seem to play a significant role. For this reason, based on its position and analysis in accordance with ISA 560 p 17, KPMG needs to take the actions that it considers appropriate to prevent continued reliance on its reports when assessing the mentioned financial reports.

4.1 Pressure against KPMG

35 In a letter from representatives from Stati et al. dated September 25, 2019, it is stated that KPMG's position may be the result of pressure from Kazakhstan. BDO have no way of assessing the extent to which pressure has been directed at KPMG from Kazakhstan or Stati et al. other than by reading the letters from Stati (appendix 3, 14 and 17) and HSF (appendix 5, 8, 11 and 19) to KPMG. From the letters that BDO have received, BDO have not noted any pressure against KPMG by legal representatives for Kazakhstan. However, BDO can note from the correspondence that there was some pressure from legal counsel for Stati et al. against KPMG.

36 As is evident from a letter sent to KPMG (appendix 14) which, in addition to KPMG in Kazakhstan, also includes KPMG in Russia, UK and US, and the information available through

public channels, the action of KPMG is something that the "market" is aware of. The evidence that KPMG has based its position on could probably be examined by the media without any major difficulties, which means that improper conduct on the part of KPMG can probably seriously damage KPMG's brand. As BDO mentioned initially, the purpose of the audit is to increase the confidence of the user of a financial report. This means that the value of an audit firm's report is greatly reduced in cases where confidence in the audit firm is damaged.

37 The amounts at dispute are significant, which means that the risk of an audit firm submitting an opinion regardless of content is high. High risk generally means increased internal control by the audit firm, which must express its opinion in order to minimize the risk of a false statement.

38 Quality is the focus of all audit firms. BDO understand by reading KPMG's transparency report (see appendix 20, page 7) that their internal regulations, which they themselves have developed, are based on the rules ISQC 1. ISQC 1 states in paragraph 34 (see appendix 21) that the audit company must determine guidelines and procedures intended to provide reasonable assurance that a) "due consultation takes place in difficult or disputed matters" and d) "the conclusion reached by consultations leads to correct action."

5. CONCLUSION

39 Based on our knowledge that KPMG applies ISQC 1, the significance of the issue for KPMG as a company and our knowledge of how difficult issues are handled at an audit firm, it is our belief that the statement KPMG made in the letters dated August 21, 2019 was prompted by a proper investigation by KPMG. It is also our assessment that the decision, to actively work to ensure that no one relies on the reports submitted by KPMG, has not been taken without KPMG having consulted its main experts on IAS and specifically IAS 560, as this is a requirement that auditing firms must comply with.

Stockholm, 25 November 2019

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6. APPENDICES

Appendix 1 –	CV Mats Jakobsson	
Appendix 2 -	KPMG letter to Stati	2016-02-15
Appendix 3 –	Stati letter to KPMG	2016-02-26
Appendix 4 –	KPMG letter to Stati	2016-03-10
Appendix 5 -	HSF letter to KPMG	2019-07-05
Appendix 6 -	KPMG letter to HSF	2019-07.17
Appendix 7 –	KPMG letter to Stati	2019-08-05
Appendix 8 -	HSF to KPMG	2019-08-15
Appendix 9 -	KPMG letter to HSF	2019-08-21
Appendix 10 -	KPMG letter to Stati	2019-08-21
Appendix 11 -	HSF to KPMG	2019-08-30
Appendix 12 -	KPMG to HSF	2019-09-03
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Appendix 14 -	Stati letter to KPMG	2019-09-06
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