Uzbekistan

Country Financial Accountability Assessment

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ABBREVIATIONS AND ACRONYMS

AsDB: Asian Development Bank
BSL: Budget Systems Law
CAS: Country Assistance Strategy
CBU: Central Bank of Uzbekistan
COA: Chamber of Accounts
COM: Cabinet of Ministers
CPAR: Country Procurement Assessment Report
CRU: Control and Revision Unit
EBF: Extra-Budgetary Fund
ESW: Economic and Sector Work
FSU: Former Soviet Union
GFMIS: Government Financial Management Information System
GOU: Government of Uzbekistan
IAD: Internal Audit Department
IAS: International Accounting Standards
IFAC: International Federation of Accountants
IFI: International Financial Institutions
ISA: International Standards of Auditing
JSC: Joint Stock Company
IFRC: International Financial Reporting Standards
IMF: International Monetary Fund
INTOSAI: International Organizational of Supreme Audit Institutions
IPSAS: International Public Sector Accounting Standards
LTB: Local Treasury Branches
MOE: Ministry of Economy
NAS: National Accounting Standards
PER: Public Expenditure Review
PFM: Public Financial Management
PFMP: Public Financial Management Reform Project
PIP: Public Investment Program
PIU: Project Implementation Unit
SAI: Supreme Audit Institution
SPC: State Property Committee
SCC: State Customs Committee
STC: State Tax Committee

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PREFACE

This report was prepared after missions to Uzbekistan in 2003 and 2004 by a Task Team comprising Andrew Mackie (Task Team Leader, ECSPS), John Ogallo (Senior Financial Management Specialist, ECSPS), Andy Macdonald (Public Sector Consultant) and Nurmukhammad Yusupov (Consultant).

This report is based on the results of interviews and discussions with various public sector institutions as well as an analysis of data gathered during the mission including copies of relevant legislation, instructions and reports. Many Government counterparts lent their support to the CFAA Mission and engaged in the dialogue. The Bank is grateful for this cooperation.

Objectives of the CFAA

The overall objectives of the Uzbekistan CFAA are to (i) help the government strengthen its public sector financial accountability arrangements; (ii) identify and document the most significant fiduciary risks 1 in the Government public financial management systems (PFM); (iii) document the existing program of reforms and capacity building to improve transparency and accountability aspects of the PFM, making additional recommendations for capacity building, if necessary.

This is the first CFAA prepared by the Bank in Uzbekistan. Its timing is particularly relevant in the context of a period drastic fiscal adjustment and an increased focus on the efficiency and effectiveness of public spending. Changes to the constitution and budgetary reforms are being undertaken by the Government, with support from the donor community. The public financial management framework in Uzbekistan is still evolving, and improvements are required in many of its components. The CFAA provides an analysis of current issues, focusing on practical, realistic and sequenced improvements in the country’s PFM systems, taking into account the considerable capacity constraints in Uzbekistan. In this sense the CFAA is primarily a forward looking assessment rather than a diagnostic of existing problems, which have already been extensively documented in previous reports.

Experience from other countries has shown that, to be successful, reforms to the institutions and mechanisms of financial accountability should not been seen as an end in themselves but rather as part of broader economic, political, and fiscal reforms within government. Therefore, one of the other objectives of the Uzbekistan CFAA has been to explain the rationale for reform in a way which encourages broad dissemination beyond technical

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1 The fiduciary risk is the risk of funds not being spent for the purposes for which they have been appropriated.
financial specialists within the Government. The CFAA complements two other pieces of Bank diagnostic work; the Country Procurement Assessment Report (CPAR) which was completed in 2003 and a Public Expenditure Review (PER) which is being prepared in parallel with the CFAA.

**Approach**

The core content of the CFAA is listed below. Where possible the CFAA documents rather than duplicates analytical work carried out by the Bank and the rest of the donor community. Where a particular item is being addressed by another initiative, that donor is identified.

- Public sector budgeting [IMF, WB, USAID, US Treasury, EU TACIS]
  - scope of the budget (including the treatment of extra-budgetary funds);
  - transparency and accountability aspects of the budget process;
  - budget execution and cash management.
- Selected revenue issues [CFAA]
- Public sector accounting and reporting [IMF, WB PFMP, CFAA]
- Internal controls and internal audit [CFAA]
- External audit and parliamentary oversight [CFAA]
- Public enterprises [AsDB]
  - monitoring and oversight
  - governance, financial reporting and audit
- Arrangements for managing the proceeds of Bank lending [CFAA]

During the scoping mission it was recognized that the CFAA Team would be able to conduct a desk review of much of the budget function and place reliance on previous diagnostic work and working closely with World Bank staff conducting the Public Expenditure Review (PER) and the Public Financial Management Reform Project (PFMR). Beyond the consolidated state budget the government of Uzbekistan carries out significant amounts of resource redistribution through extra-budgetary accounts and funds, lending policies and public guarantees. Given the orientation of the CFAA and the overall materiality of the amounts involved, the Team focused considerable attention on the scope of the budget entity, accountability and transparency aspects of extra-budgetary funds and public enterprises.

Accounting, internal controls/internal audit and external audit are specific areas which have not received much attention in previous diagnostic reviews and have therefore been analyzed in support of the Government’s treasury and constitutional reforms.

Public procurement has been covered extensively in the March 2003 Country Procurement Assessment Report (CPAR). In summary, the report noted that the legislative framework, institutions and enforcement regime for public procurement are under developed. Overall the CPAR gave the procurement environment a high-risk rating. The key findings of direct relevance to the CFAA are (i) that both internal and external controls over procurement are inadequate; (ii) procurement-related corruption is a threat to public expenditure and; (iii) the private sector has little faith in the fairness of public tenders. The CPAR also recommended that internal and external audit controls over procurement should be strengthened.
The assistance provided by donors supports Government’s efforts to establish modern financial institutions and develop staff skills and capabilities to enable it to manage its own affairs. The CFAA identifies those initiatives already underway, assesses the Government’s progress in each area and comments on their future plans. Where additional actions are recommended these are presented in a Development Action Matrix (see Annex I), which identify a series of proposals highlight (i) legislative reforms, (ii) institutional arrangements, (iii) human resource and capacity building and (iv) suggested timing (short, medium or long term) of implementation of the proposed action.

Acknowledgements

The CFAA team wishes to acknowledge the extensive and grateful cooperation and assistance received from staff in the various institutions who contributed to the CFAA, including officials and staff of the Government, state agencies and enterprises, and bi-lateral and multilateral organizations. Grateful thanks also go to the Bank’s Public Expenditure Review and Public Financial Reform Project task team, particularly Ritu Anand and Roland Clarke. In addition Martin Raiser (Uzbekistan Country Manager) and Bakhtior Abdullaev (Uzbekistan Country Officer) provided invaluable in-country assistance and information. John Hegarty (Manager, Financial Management, ECA), Pascale de Kervyn Letenhove (ECSPS) and peer reviewers, Dimitar Radev (IMF), Roland Clarke (ECSP) and Hisham Ahmed Waly (MCACS) offered much appreciated comments and inputs.
EXECUTIVE SUMMARY

Introduction

Since declaring its independence in August 1991, Uzbekistan has taken a markedly different course from most Commonwealth of Independent States (CIS) countries by following a gradual transition to a market economy and adopting a development strategy aimed at accelerated industrialization. While taking initial steps to the transition to a market-based economy, the State has retained the levers of control over the reform process and an extensive role in the economy.

In the past five years Uzbekistan has faced a drastic fiscal adjustment following a decline in budget revenues. The aggregate level of government spending has come down, extra-budgetary funds have been reduced and streamlined somewhat, and redistribution through quasi-fiscal operations has decreased. General government expenditures, including those financed by government guaranteed borrowing, have come down by over 11 percentage points of GDP since 1998.

The outlook is for public resources to become scarcer as the reforms progress further. It is vital that the Government focus on the effectiveness of public spending and minimize and inefficiencies. There are a number of elements on which the Government could build improvements to the framework of public accountability. A new Constitution has been passed and a bi-cameral parliamentary system began operations in January 2005. Major reforms to the health and education sector have begun. Elements of the budget process are already being addressed through the development of revised budget preparation procedures and the introduction of a treasury system.

These reforms require fundamental changes to the institutions of government and to the attitudes of public servants. Policy making functions of spending ministries need to be developed and accountability for policy and spending decisions needs to be clarified. Management in budgetary institutions needs new tools and institutions to establish, maintain and be held accountable for the internal control environment.

This Report has been prepared with the overriding goal of helping the government in their efforts towards strengthening control and accountability and supporting greater efficiency of public spending. The Report examines all areas of public sector accountability, including accountability and transparency aspects of the budget, accounting and external financial reporting, revenue management, the internal control environment, internal and external audit and governance of public enterprises. The goal has been to present a forward-looking analysis of current issues, focusing on practical, realistic and sequenced improvements in the Country’s public financial management systems. The recommendations have taken into account the considerable capacity constraints in Uzbekistan and the limited history of reform in an environment marked by severe deficiencies in transparency and accountability.

Ultimately, technical improvements in financial management will only be successful if they are supported by overarching institutional, economic and political reforms. Good financial management practices underlie government’s accountability to its citizens through a transparent, efficient and effective use of public funds.
The key analysis and recommendations for establishing a sound financial accountability framework are described in the following paragraphs:

**Public sector budget management**

**Budget management processes** in Uzbekistan create considerable risks to the Government. The first risk is a policy risk; it is the risk that policies passed by Parliament are not implemented through the budget. The second risk, a budget and financial management risk, is the possibility that funds are not spent according to their intended use. This risk is compounded by a large share (about 25 percent) of off-budget resources not subject to budget scrutiny.

In Uzbekistan, the policy risk is significant owing to process and institutional breakdowns between policies and budgeting. The greatest challenge in the reform of Uzbekistan’s public finances is to make the transition from institutions inherited from the centrally planned economy, to ones in which policy making is linked to budgeting. Much of the reform process requires fundamental changes, largely outside and beyond the Ministry of Finance. First, the Government should clarify the long term role of the public sector in the economy, with a view to accelerating the transition towards a market-based economy supported by transparent and accountable public institutions. While economic and sector policies are developed, institutions should be established at the center of government to coordinate strategic policy choices. Spending ministries should be reorganized along functional lines and include under them many of the state institutions which deal directly with the MOF. New budgeting processes and the establishment of the Treasury, will of course require work within the MOF. However, until now budget reform has largely been centered around technical developments within the MOF. One of the main tasks for the MOF is to make the case to the Government and public institutions for the need for reforms and the long term benefits that will ensue.

There is also a high risk that funds may not be used for their intended purposes, as the budget lacks comprehensiveness and limited budget information prohibits meaningful budget scrutiny. The present budget is not comprehensive, and the budget process is fragmented. Extra-budgetary funds account for one quarter of state budget expenditure and are not subject to the same scrutiny as the budget. In addition, the formulation of investment budget is a separate process; there is no mechanism for consideration of the impact of future recurrent costs in evaluating new investments, nor is there a mechanism for debt recording of externally financed investments.

The CFAA recommends that no new extra-budgetary funds be created and that existing funds should be subject to the same rules for budget preparation, review and audit as the budget. In addition, the process for recurrent and investment budget preparation should be merged with due consideration of recurrent costs and debt impact in later years.

The transparency of budget documentation also needs to be significantly improved. The present budget classification is rudimentary and insufficient to analyze the development of policy or serve as a basis to hold spending units accountable through budget execution. Transparency and accountability would be enhanced by the publication of budget documentation which includes the budget, macroeconomic forecasts and an explanation of the main budgetary measures.

In Uzbekistan, the present budget execution arrangements are inefficient and non-transparent; exposing the government to the risk (a) that payments are not made in accordance with the
budget, (b) that payments are not made on a timely basis and distort the implementation of government activities and (c) that finance officials have insufficient information to make the most effective and efficient use of cash. Disbursement takes place through numerous government bank accounts held in commercial banks. This makes budget implementation difficult to monitor and liquidity impossible to manage. Numerous extra-budgetary accounts further weaken liquidity management, budget execution monitoring and control. These problems are recognized by MOF who has begun work on the introduction of a treasury system with the support of the IMF and World Bank. The establishment of the Treasury requires a major institutional reorganization of MOF and considerable capacity building in the finance function across all areas of government.

Public sector accounting

Uzbekistan’s public sector accounting traditions were inherited from the Soviet Union; where budget reporting was merely a financial reflection of detailed production plans. Developing a modern accounting system and financial reporting system will protect and manage public money and discharge accountability. The government has a large number of bookkeepers who are familiar with double entry, accrual based accounting but who are reliant on manual systems and will need training on modern financial accounting and reporting. As part of the treasury reforms the Government has developed a well thought-out development plan for the phased introduction of accounting reforms based on International Public Sector Accounting Standards (IPSAS). The Report recommends that training on public sector accounting begins immediately and cautions against ambitions running ahead of available capacity. Specifically, accruals accounting should remain a long term goal once the government has successfully implemented and reported in compliance with the cash basis of accounting.

Revenue administration issues

As regards the revenue collection agencies the Report notes the Government’s investment in management information systems and efforts to improve the quality of reporting between collection agencies and MOF. However, the Government still faces a major challenge of enforcing tax policy without stifling the development of legitimate economic activity. The complexities of the current tax policy may discourage compliance. The CFAA also echoes previous reports in recommending that the commercial banking sector stops acting as a de-facto tax enforcement agency. The Report also recommends that the Government pass a proposed amendment to the Tax Code restricting access to taxpayers’ banking information.

Internal control and internal audit

In common with other transition economies in the region concepts of internal control and internal audit are not well understood. The present fragmented execution system (discussed above) results in a loss of budgetary control which can be addressed, in part through the reform of treasury systems. Long term reforms to institutions which monitor and control the budgetary process are also required. The present approach of the Control and Revision Unit of MOF (CRU) focuses on top-down controls over compliance which do nothing to support managers in budgetary institutions establish, maintain and be held accountable for the internal control environment. The Report proposes a phased approach to reform which builds capacity in tandem with the on-going treasury reforms and prepares CRU for a long term role as a modern internal audit department within Government.
External audit

Effective **external audit** provides an independent assessment that the overall objectives set by Parliament and government have been reflected in the budget, scrutinizes the overall quality of public expenditure, and management of public assets and liabilities. To date limited progress has been made on the development of an independent public sector external audit function in Uzbekistan. The constitutional and budgetary reforms present an opportunity to develop such an institution. A small Chamber of Accounts (COA) has been created within the President’s Office and could be developed into an external audit function. The Report proposes a four point development plan: (1) establishing a legislative base for the audit function; (2) increasing the transparency and disclosure of its work; (3) providing additional resources to the COA; and (4) enlisting the support of the international community to assist in its development. A long term goal for the COA should be to provide a professional opinion on the government annual budget report based on international accounting standards.

Public enterprises

Uzbekistan still has a large number of **public enterprises**. Due to ill-defined lines of authority there is little external and internal discipline on corporate performance, and little separation between government and business. The Report recommends reforms to the regulatory framework; separating policy and regulatory activities where conflicts of interest arise and privatizing commercial operations so they do not have access to state powers. The transparency of financial information should be improved by a phased introduction of publicly available financial reports prepared and audited in accordance with international standards of accounting and auditing.

Capacity building

The capacity of the Government to absorb and implement an ambitious series of public sector financial management reforms will be a challenging long term exercise. Financial management training is needed in all public sector institutions but the needs are particularly acute in the regions and in budgetary institutions. Many finance officers have had no formal training since the 1980’s and there is a lack of computers and basic guidelines to assist staff. Many of the international developments in budgeting, accounting and auditing are completely new to technical finance specialists. They need broad exposure to the latest techniques which should also be introduced into academic programs. A high level of literacy and numeracy, an adaptable population, and well-developed educational institutions offer obvious opportunities for improvement.

Development Action Matrix

The assistance provided by donors supports the Government’s efforts to establish modern financial institutions and to develop staff skills and capabilities to enable it to manage its own affairs. The CFAA identifies those initiatives already underway, assesses the Government’s progress in each area and comments on their future plans. Where additional actions are recommended these are presented in a Development Action Matrix (see Annex I), which identifies a series of proposals highlighting, if applicable (i) legislative reforms, (ii) institutional arrangements, (iii) human resource and capacity building and (iv) suggested timing (short, medium or long term) of implementation of the proposed reform.
*Underpinning a genuine reform process is the improvement in transparency of Government’s management of public resources. At this juncture, the Government could demonstrate its commitment to greater transparency with the following measures (included in the Matrix) which do not requiring external assistance.

1. Budget preparation should be made more transparent with the publication of the budget, together with documentation on its assumptions and main lines of policy.

2. In the area of extra-budgetary fund management, at a minimum no new extra-budgetary fund should be created; and existing funds should be incorporated into the Budget where possible. In addition, the Government should amend Decree 414 to limit extra-budgetary funds to the payments of paid services and not allow budget surpluses.

3. Revenue management needs to be made more transparent: the Government should implement the proposed amendment to the Tax Code to restrict access of the tax authorities to the banking information of taxpayers.

4. The Government should enhance transparency in public enterprise management by selecting two public enterprises for pilot audits of their 2004 financial statements according to international standards. The results of these audits should be published.

At the same time the Government should also start exploring possible external support for medium-term reforms particularly in the areas of internal and external audit.

* Reforms in financial management and accountability do not happen in a vacuum. Such reforms are unlikely to succeed unless overall political conditions and commitment is fueling them. In addition to political commitment, the management of the transition has to be thought through. Finally, linkages between public financial management and overall public sector reforms have to be understood and addressed.
I. COUNTRY BACKGROUND

Governing Structures

1. An independent Uzbekistan was created in 1991. Of the 15 countries which emerged from the breakup of the Soviet Union, it is the third largest in terms of population (25.2 million) and the fourth largest in terms of land mass (447,000 square kilometers). Islam Karimov has been the country’s President since independence.

2. Following a referendum, the Constitution has been amended to permit the creation of a bicameral parliamentary system that began operations in January 2005, replacing the present unicameral system. This will consist of an elected upper house (Senate) and an elected lower house (Legislative Chamber). A number of powers previously exercised by the President have been transferred to the Senate, including the appointment of the Prime Minister. The President has stated that the full time representatives of the lower house will focus principally on legislative issues while the Senate will provide for territorial representation. Under the revised Constitution the President’s term of office was also extended from 5 to 7 years.

Economic background and prospects

3. While taking initial steps to the transition to a market-based economy, the State has retained an extensive role in the economy. The state continues to be involved in a wide range of off-budget economic activities managing whole sectors of the economy such as cotton production. Instances such as when the authorities require enterprises to perform work without payment, for example by providing employees for cotton picking or paying for urban beautification projects, point to a much larger influence of the state than is indicated by the quantifiable fiscal and quasifiscal operations. If control over the economy through parastatal industrial associations and state-owned commercial banks, centralized planning of production and distribution, and heavy regulatory burden are added, the reach of the state is greater still. Progress in privatizing large firms in the banking, mining and utility sectors such as telecommunications, energy, and transport has been slow. The slow transition of the Uzbek economy resulted in high levels of Government revenues and expenditures for public and publicly guaranteed investment and extra-budgetary funds, which reached 60 percent of GDP in the mid-1990s. In the past five years there has been a drastic fiscal adjustment following a decline in budget revenues. Between 1998 and 2003 consolidated budget expenditures, including extra-budgetary funds and net lending were slashed by 10 percentage points of GDP. The aggregate level of government spending also saw similar dramatic declines during the period.

4. Throughout the late 1990’s the Government imposed strict currency controls and Government continued to set prices and quantities in major sectors (agriculture, mining and energy) of the Uzbek economy. This enabled the Government to avoid the output slump experienced in other transition economies but it also resulted in below average growth in the post-transition period. As a result merchandise exports fell 32 percent between 1997 and 2001, and another 14 percent in 2002 alone.\footnote{World Bank, Uzbekistan Country Brief, 2003 p. 1.} Per capita net FDI is now the lowest in the CIS,
and the GDP per capita of $2360 is third lowest. Following a series of exchange rate devaluations the gap between official and parallel market rates, which stood at over 400 percent in early 2000, has been virtually eliminated, and in October 2003 the authorities announced the introduction of convertibility.

5. External developments have been favorable for Uzbekistan since late 2002. Prices of its main export commodities – cotton and gold – rose sharply, contributing to the growth of exports of goods and services by 27 percent in value terms and boosting foreign exchange reserves by over 0.4 bn. soums. As a result, all of Uzbekistan’s external debt ratios improved and were below their values in 2000 when external borrowing was tightened. The world market prices, however, are volatile. The key factors for improvement of Uzbekistan’s creditworthiness are, in addition to continued the tight borrowing policies of recent years, an improved environment for economic growth, diversification and a further sustained increase of exports. This will be hard to achieve without a reorientation from the current inward-oriented strategy based on the dominant role of the state to a more open, market-oriented development strategy.

**Relationship of the CFAA, lending program and policy dialogue with the Country’s authorities**

6. The FY02-04 Country Assistance Strategy (CAS) included the completion of the CFAA as a core non-lending activity of the Bank during the period. With an overarching goal of improving living standards and alleviating poverty in Uzbekistan the CAS recognizes the importance of developing Uzbekistan’s public sector institutions and systems of governance especially in the areas of transparency and accountability. A new CAS for FY05-07 is currently being prepared. Subject to the outcome of the 2005-07 CAS discussions several new operations could enter the portfolio in FY05, including the Public Financial Management Reform (PFMR) Project, which supports the important reforms to budget processes discussed in this Report.

7. Since Uzbekistan joined the World Bank and the IDA in 1992 it has been supported with a modest program of lending, technical assistance and policy advice in support of its reforms. The primary areas of attention have been: reforms in public policy to increase transparency, liberalization of trade and fiscal reforms; private sector development to help alleviate poverty through job and wealth creation; human capital investment; and irrigation and drainage investments to improve productivity. A summary of Bank lending is shown below:

### Table 1: World Bank Lending to Uzbekistan ($ Million)

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<td>599</td>
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<td>26</td>
<td>36</td>
<td>44</td>
<td>17</td>
<td>268</td>
</tr>
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3 Ibid; GDP per capita refers to 2000.
8. The limited lending program has been complemented by non-lending activities centered around selected fiduciary economic and sector studies. The Bank completed the Country Procurement Assessment Report (CPAR) in 2003 and a Public Expenditure Review (PER) has been prepared in parallel with the CFAA.

9. The Bank’s lending activity has been focused on investment projects. Fiduciary safeguards and financial management in the Uzbekistan portfolio are arranged outside the national institutions of accountability using stand-alone project implementation units. Budget support operations are not envisaged in the next CAS cycle.
II. PUBLIC SECTOR BUDGET MANAGEMENT

Introduction

10. The focus of CFAA is on budgetary issues which impact on public sector financial accountability. The Report analyzes both the comprehensiveness and transparency of the budget process. Later sections of the report analyze accountability and transparency issues arising from extra-budgetary funds and public enterprises.

11. This Report does not provide a detailed examination of institutional reforms required to reform the budgetary process; nor does it review the allocation of resources against government priorities. These issues are the domain of the Public Expenditure Review (the key institutional issues arising from the PER analysis are summarized in Box 1 below). The problems inherent within the present system of budget management have been documented in previous reports. The main focus of this chapter is to explain the rationale for the development of a treasury system and provide a deeper understanding of the challenges posed by this far-reaching initiative.

Principles and Risks

12. Public sector budgeting poses two types of risk to sound financial management. Firstly there is the policy risk related to the government failing to implement the budget passed by the Parliament. As discussed above, these issues are primarily dealt with in the context of the PER. Second, there is the financial management risk that budgetary funds are not spent for the purposes set out in the budget. This risk is compounded when significant government activities operating outside the budget are not subject to normal budget scrutiny and procedures. These issues are discussed below.

13. The budget execution arrangements have an important impact on the management of the government’s liquidity position and cash requirements. A failure to manage liquidity efficiently creates risks (1) that payments are not made in accordance with the budget, (2) that payments are not made on a timely basis and distort the implementation of government activities and (3) that finance officials have insufficient information to make the most effective and efficient use of cash.

14. To understand the scope of these risks, the following dimension and principles of budgeting should be reviewed:

- **The scope of the budget**: is the budget comprehensive enough to allow effective policy and resources linkages, review and trade-offs? Similarly, are the resources outside the budget subject to the same policy, review, financial reporting and accountability requirements?

- **The budget preparation process**: Is data on budget preparation and implementation available, timely, reliable and presented in a way that allows the Government to assess implementation of public policies? Is the budget preparation process conducive to fiscal sustainability and responsibility, and does it link policies and resources?

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• **Budget presentation**: Is the budget presentation transparent and clear enough to assess whether it reflects the Government policy priorities, and is the use of the funds clearly spelled out?

• **Availability and quality of budget information**: is the budget available outside the Executive to allow for open review of the Government’s proposed use of funds?

**The scope of the budget**

15. **In Uzbekistan, the budget excludes a significant portion of public funds.** As a result, it does not allow effective policy and resources linkages, review and trade-offs and does not present a comprehensive view of the government sector.

16. **Extra-budgetary funds (EBFs) are a large part of total State expenditure.** EBFs account for approximately one quarter of total State budget expenditures; and include four major funds\(^5\) and additional smaller EBFs (accounting for less than 10 percent of total EBF expenditure). Many of the smaller EBFs are designed to provide incentives to budget entities engaged in revenue production. The state budget does not cover all government agencies and previous studies have recommended that the government bring all controlled entities into a consolidated reporting entity. In doing so EBFs would be consolidated into the budget and more accurately reflects central budget activities. Because of their overall materiality the issue of extra-budgetary accounts is discussed in greater depth in the next section of the CFAA.

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Uzbekistan has begun major reforms to the health and education sector. Budget preparation and execution weaknesses are being addressed through the development of revised budget preparation procedures and the introduction of a Treasury system. These changes are part of a long term process requiring a fundamental change in institutions across government. Policy making functions of spending ministries need to be developed; accountability for policy and spending decisions need to be clarified.

In the long term much of the reform of public finances will require changes outside the Ministry of Finance. Institutions should be established at the center of government to coordinate strategic policy choices. Spending ministries should be reorganized along functional lines and include many of the state institutions which currently deal directly with MOF. Until now budget reform has largely been centered around technical developments within the MOF. One of the main tasks for the MOF is to make the case to the Government and public institutions for the need for reforms and the long term benefits that will ensue.

Amongst the key short term recommendations of the PER are proposals which would make the presentation of the budget more transparent and enable the Oliy Majlis to evaluate the effectiveness of the allocation of resources. In the medium to long term the PER proposes structural changes to MOF; creating a modern organization equipped to perform the development of macro-economic policy and sustainable expenditure. The PER also recommends the creation of high level committee of the Cabinet of Ministers (COM) responsible for overseeing the budget process and presenting strategic choices to the COM.

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*Source- Public Expenditure Review, 2004*

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\(^5\) Road Fund, Pension Fund, Employment Fund and State Property Fund.
The budget preparation process

17. Policy development takes place centrally in the apparatus of the Cabinet of Ministers and the Presidential Administration. Strategic decisions take place outside the budgetary process, which means that funding for new initiatives may be lacking or the budget will be allocated in an ad hoc manner by MOF. Until recently there was no initial resource envelope specified in calling for budget requests. For the first time in the 2005 budget process expenditure ceilings were set for sectors. This is an important step forward in the budget process. However the process of setting ceilings will require further development and formalization. In particular it is important that COM approves budget ceilings for institutions and not just functions, and the process of setting ceilings should be codified in the Budget Systems Law (BSL) or in regulations issued by the MOF based on the BSL. Budget requests are based upon standard cost norms and historic allocations. Notwithstanding the improvements, the present budget preparation process is not conducive to fiscal sustainability, nor does it link policies to resources.

18. There is no integrated evaluation of investment and current spending in each sector. The lead agency for the investment budget is not the MOF but by the MOE which is responsible for the PIP. Although MOF officials are involved in this process and all projects are formally subject to a process of appraisal, they are not evaluated together with other public resources being assigned to a particular sector, within a budgetary envelope for the sector. In addition a number of basic decisions in the PIP are taken outside the formal budget process (for example, a priori decisions on the numbers of schools and hospitals to be constructed). There is also no mechanism for the consideration of the impact of recurrent cost implications (beyond the next budget year) of new investments.

19. Separation of PIP and external financing promotes the view that such resources are additional or free. Since a significant proportion of the PIP is financed from external borrowing, the existence of the PIP in its present form promotes the view that foreign financing is in some sense “free” money apart from the budget. Although the appraisal of PIP projects does include an assessment of the ability to repay the loans these are not taken into account as part of the budgetary envelope available for spending by institutions.

Transparency and accountability aspects of the budget process

20. Budget documentation is not transparent and clear enough to assess whether it reflects the Government policy priorities, and the use of the funds is not clearly spelled out. In addition, the budget process does not lend itself open review of the Government’s proposed use of funds.

21. Budget presentation suffers from the fragmented budget (discussed above) and a classification which does not meet international standards. The overview tables on spending are insufficient to analyze the development of policy. Greater transparency could be achieved through presenting the budget by organizational and economic classification, with comparative data for the previous year and forecasts for the next two years.

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6 The PIP covers both General Government investment (centralized investments) as well as that carried out by public enterprises financed from their own resources and direct foreign investment (decentralized investments).
22. **The budget classification used for structuring the information does not allow clear accountability for the use of resources.** The functional classification is a mix of functional elements and economic categories, and the economic classification is limited to four categories, as noted above. Recently considerable work has been carried out in the MOF, with the assistance of the IMF and US Treasury to develop functional, economic, organizational and program classifications, consistent with the standard GFS 2001 classifications of the IMF. This classification identifies the structural unit, the budget beneficiary and the main activity for which budget funding will be used. If this classification is used for the presentation and execution of the budget, it would allow for clear accountability in the use of resources by institutions, and provide the Oliy Majlis and COM with a means to evaluate the budget in a coherent manner. It is expected that the GFS 2001 classification will be implemented for the 2006 budget and, in addition a programmatic budget classification will be implemented in 2007.

23. **The Oliy Majlis approve a budget based on broad functional classification.** Parliamentarians are provided with an aggregated overview of proposed government budgetary expenditures and revenues and the tax and fee levels that will be required to meet the revenue budget targets. While additional information is available on request, the format and the highly aggregated level of the information makes it difficult for an individual parliamentarian to formulate an informed opinion. The broad budget parameters are also disclosed, for the first time this year, on the MOF website. What are missing are the detailed disclosures of the individual budgets of the first line budget entities and their sub-entities that compose the main budget variables.

24. **The detailed budget is prepared after approval by the Oliy Majlis.** Once the budget is approved in parliament a second budget process begins. Since the budget approved by the legislature does not assign resources to institutions and economic categories, it is only following the approval of the budgets that the negotiations and allocation of budgets of institutions at the central level takes place by the MOF. A similar process also then takes place at the Oblast level for local institutions. On the revenue side the revenue forecasts are broken down by type of tax and locality to reflect revenue raising plans which become obligatory for the local governments.

25. **Transparency and accountability would be enhanced by the publication of Budget documentation.** Publication is standard international practice in virtually all countries in the world. The decision of the Government to begin publishing the details of budget execution for 2003 is very welcome and institutionalization of this practice would be an important step forward in transparency. In particular this would include the budget, the macroeconomic forecasts underlying it and an explanation of the main budgetary measures.

**Budget execution and cash management issues**

26. **Fragmented organizational arrangements for the budget make implementation difficult to monitor.** Budget execution takes place through the Central Bank of Uzbekistan (CBU) and commercial banks on the basis of a monthly cash release system. There is no distinction between the authority to spend and the release of funds. Cash is disbursed into thousands of individual bank accounts of budget institutions. The CBU estimates that there are 120,000 Government bank accounts.
27. **The present budget execution arrangements expose the Government to important risks** (1) that payments are not made in accordance with the budget, (2) that payments are not made on a timely basis and distort the implementation of government activities and (3) that finance officials have insufficient information to make the most effective and efficient use of cash. These risks are recognized by the Government and are being addressed through the development of the treasury system.

28. **There is uncertainty in the availability and timing of funds.** In principle, budget funds are released to spending agencies on the basis of monthly expenditure plans. Although funds released over the whole year are in accordance with the approved budget, to keep cash under control these releases are not automatic and are prioritized by the MOF or the Oblast Finance Department. The timing of availability of funds is determined in part by the availability of revenue (dependent on seasonal or local fluctuations) at the relevant level of decision-making (MOF, oblast or rayon). The need for prioritization\(^7\) in release of cash makes control of execution a source of political and economic power, and subject to lobbying and rent-seeking\(^8\). The resulting uncertainty as to the timing of the release of funds generates incentives to cash hoarding and the accumulation of idle balances by budget organizations. Cash management is further complicated by the rationing of cash by the CBU to the banking system. Even when funds are made available through the banking system to the bank accounts of BIs, these are unable to make payments in cash to final recipients. As a result arrears of several months have occurred in wage and pension payments in some areas.

29. **Extra budgetary accounts in the banking system further weaken liquidity management and fiscal control.** Spending agencies use extra-budgetary accounts (established under decree 414) to manage their own resources. While such arrangements facilitate cost recovery, the high number of extra-budgetary bank accounts maintained by budget institutions creates further loopholes in the fiscal control system.

**Recent and proposed reforms**

30. **Many of the weaknesses highlighted above are being addressed through the introduction of a treasury system and work on the budget preparation process.** The MOF has begun work on a modern treasury system with the support of the IMF and the Bank’s Public Finance Reform project. A US Treasury Advisor is assisting the Ministry of Finance with improving its budget preparation procedures including revising the budget classifications (introducing an organizational classification), strengthening the legal framework of the budgetary process and improving the format and the content of budget submissions prepared by line ministries.

31. **A modern treasury system offers a number of potential benefits which can address the limitations of the current system and will assist in the implementation of budget plans and the management of public resources.** Firstly, the creation of a single treasury account and daily cash reports will enable the government to manage cash, financial assets and short term investments efficiently. The result will be a reduction in the cost of idle balances and an increase in cash predictability which can be made available to spending

\(^7\) Priority is given to wages, pensions and utility payments.

\(^8\) The problem is exacerbated by unclear lines of accountability of the local finance departments which report to both the MOF and the Oblast authorities.
units. Second improved reporting through a modern Government Financial Management Information System (GFMIS) provides better analytical information to monitor the budget execution process at all levels of government. Reporting of expenditures provide reliable and timely assurance that public resources have been used in conformity with the legal authorizations and mandatory requirements. Officials can monitor the proportion of appropriations not committed and expenses committed but unpaid. Finally, systems and procedures improve the management of domestic and foreign debt through regular recording and reporting of loans including their associated disbursement and repayment schedules.

32. **The establishment of the Treasury entails a major institutional reorganization for MOF.** Under the draft proposals the Treasury will be established as a unit of the MOF, headed by a Deputy Minister, and it will comprise a Central Treasury (CT) located in the head office of the MOF and a network of local treasury branches (LTBs) throughout Uzbekistan. Under the new arrangements the LTBs would be directly subordinate to the CT and not to local Governments.

33. **The treasury reforms will require considerable capacity building.** The capacity of the Government to absorb and implement an ambitious series of public sector financial management reforms will be a challenging and on-going exercise. Finance training is needed in all public sector institutions but is particularly acute in the regions and in budgetary institutions. Many finance officers have had no formal training since the 1980’s and there is a lack of computers and basic guidelines to assist staff.

34. MOF have identified 21,000 new and existing staff sub-divided into (i) treasury staff, (ii) finance officers in MOF, oblast and rayon level finance offices and (iii) finance and accounting officers in budgetary units (predominantly in the health and education sectors). MOF propose to set up a training facility in the Treasury building to accommodate classrooms. The MOF will develop initial trainers for trainers program and develop training materials and modules based on the skill and competences required of finance officers.

**Main Recommendations**

35. The recommendations included in this section are consistent with the analysis and conclusions drawn in the PER and are repeated in CFAA for continuity of reporting.

**Short term (within one year)**

36. **Adopt fully the outline budget process developed for the 2005 budget.**

i) PIP should be prepared in close collaboration with the Ministry of Finance in the selection of projects.

ii) The budget is formulated around the organizational and programmatic classification is presented to the COM and Oliy Majlis in that form.

37. **The budget, together with documentation on its assumptions and main lines of policy, should be published.**

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9 Discussed in greater detail in Section IV.
Medium term (one to three years)

38. **The Budget System Law should be amended. The principal amendments required are:**

   i) To require the *enactment* of the budget by the Oliy Majlis.
   
   ii) To define appropriations as an authority to spend separate from the release of cash. This is essential for the introduction of the Treasury.

39. **Multi-year PIP process should be reinstated and coordinated by MOF.** The choice of projects within the general government sphere should be coordinated by the MOF as part of an annual and medium term budget process. The MOE should be responsible for developing methodology for project appraisal and quality control of proposed projects. The MOF should maintain a database of ongoing projects showing their impact on future recurrent costs, which should be integrated into a wider medium term budget perspective.

40. **Transparent operational rules and procedures should be developed for the Treasury control of budget execution.** The rules should allow the Treasury to verify the legality of payments, but give it no authority to prioritize payments except by rules that are published by the MOF. The rules for managing budget execution should allow different levels of control of expenditure, and be consistent with sectoral reforms.
III. EXTRA BUDGETARY FUNDS

Introduction

41. Extra-budgetary funds pose three types of risk to sound financial management. Firstly there is the policy risk that through poor government oversight and operational management extra-budgetary funds fail to meet overall policy objectives. Second, there is the performance risk, where use of the funds for their intended purposes cannot be ascertained due to poor oversight and management. Finally, there is the financial risk. It has two sub-components:

- **Fiscal risk**: the fund may overspend its general budget allocation through weak commitment controls or unauthorized borrowing;
- **Cash management risk**: by holding separate extra-budgetary funds the Government may have to either borrow funds when idle balances remain in the fund bank accounts or reduce cash allocations to other programs to accommodate the increased demands of the extra-budgetary fund.

42. The second and third risks (performance and financial risks) are the most relevant to the CFAA diagnostic. These risks occur because extra-budgetary accounts are off-budget and often operate outside the general budget formulation, execution, and reporting system. Simply including the fund balance sheet in the annual Government budget documentation would not be sufficient as they would still not be subject to normal budget scrutiny and procedures.

Extra-Budgetary Funds in Uzbekistan

43. The overall amounts of spending of extra-budgetary funds in Uzbekistan are highly material, accounting for approximately one quarter of total State budget expenditures. Table 1 provides details of the spending on the four major funds and over 20 smaller funds (accounting for less than 10 percent of total extra-budgetary expenditure and presented in aggregated form).

44. The smaller funds have been established principally to provide incentives to budget entities engaged in revenue production. These revenues can then be spent on staff bonuses, benefits, and other spending related to the entity. Revenues include the tax and customs commissions (20 percent of penalties collected), State Property Commission (1 percent of privatization revenues, MOF (10 percent of CRU recoveries to the state budget) 11.

45. In addition spending agencies use extra-budgetary accounts (established under decree 414) to manage to provide greater flexibility in the budget execution process. It creates provisions which allow budget entities to transfer unused budgetary funds into an extra-budgetary account, known as a development fund. The number of these funds is roughly equal to the number of budget entities, approximately 13,000. These development accounts are off-budget and non-lapsing at year-end, and are not subject to normal budget

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10 A list of all extra-budgetary funds is included in Annex IV.
11 The allocation of fees and penalties to extra-budgetary funds of the ministries were reduced by COM Resolution in 2003. The Resolution also provides for estimates of extra-budgetary funds to be registered with the Ministry of Finance and is taken into account in the budget formulation process.
execution controls. In 2003, total expenditures from these accounts were estimated at 10 percent of budgetary expenditures. These development accounts are maintained in commercial banks.

**Table 2: Extra-budgetary fund spending 1999-2004 (Billion Soums)**

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<tbody>
<tr>
<td>Road Fund</td>
<td>32.0</td>
<td>51.7</td>
<td>72.4</td>
<td>123.1</td>
<td>140.3</td>
<td>152.0</td>
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<td>Pension Fund</td>
<td>152.4</td>
<td>219.6</td>
<td>332.8</td>
<td>470.8</td>
<td>597.6</td>
<td>745.2</td>
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<tr>
<td>Employment Fund</td>
<td>7.7</td>
<td>8.6</td>
<td>12.5</td>
<td>18.0</td>
<td>24.4</td>
<td>21.0</td>
</tr>
<tr>
<td>State Assets Fund</td>
<td>4.3</td>
<td>8.6</td>
<td>21.1</td>
<td>10.3</td>
<td>55.8</td>
<td>18.2</td>
</tr>
<tr>
<td>All Other EBFs</td>
<td>16.4</td>
<td>18.7</td>
<td>16.3</td>
<td>47.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>TOTAL EBFs</td>
<td>212.8</td>
<td>306.3</td>
<td>455.1</td>
<td>669.2</td>
<td>818.1</td>
<td>936.4</td>
</tr>
<tr>
<td>EBF/Percent of State Budget incl. EBFs</td>
<td>24.4%</td>
<td>24.5%</td>
<td>25.7%</td>
<td>25.8%</td>
<td>24.7%*</td>
<td>28.0%*</td>
</tr>
</tbody>
</table>

*Source: Ministry of Finance. n/a – not available; * = excluding other EBFs.*

**Impact of extra-budgetary funds**

**Budget and cash management issues**

46. **Extra-budgetary funding further fragments the budgetary process and creates significant policy risks.** The smaller funds have been created with their own sources of income, and cover recurrent expenditures such as maintenance, repairs or subsidies in different sectors, which are the items being squeezed under the current budgeting process. The creation of extra-budgetary funds for these purposes is a substitute for an effective budget process and reflects an inability to prioritize. If an overriding need for maintenance, staff incentives or any other expenditure is recognized this should be provided for through the normal budget process.

47. **No new extra-budgetary funds should be created.** The creation of extra-budgetary funds is a symptom of failures of the budget process to allocate sufficient funds for activities such as maintenance and capital purchases. These funds are often created as a result of political lobbying or ad hoc priority setting at a higher level. In the case of the smaller funds these account for a subset of expenditure within sectors which should be more properly be considered under normal budgetary processes. For this reason the government should plan to wind these funds up in the medium term. It is recognized that the Government is making efforts to reduce the number of extra-budgetary funds, but the recent creation of a new earmarked fund for basic education is a cause for concern, because of the way in which these funds circumvent the normal budgetary processes.

48. **Controlling of extra-budgetary funds could be linked to greater flexibility in spending.** Since many of the smaller funds were introduced to give more flexibility to spending institutions, their abolition has to be linked with measures which give institutions
more flexibility in spending. This could be achieved by reducing the level of detail in the expenditure tables and allowing greater scope for virement without reference to the Ministry of Finance.

49. **Extra-budgetary funds in the banking system weaken fiscal control and expose government to fiscal risks.** While development accounts facilitate cost recovery, the high number of extra-budgetary bank accounts maintained by Budget Institutions creates loopholes in the fiscal control system. The existence of separate bank accounts also increases financing costs and fiscal risks if funds are able to borrow.

*Governance issues*

50. The CFAA conducted a review of the four major funds financial management processes and controls (see Annex III). From this analysis it appears that extra-budgetary funds are not as stringently monitored and controlled as other budget entities. For example while budgets are tabled in Parliament with the state budget there is no legal requirement for extra-budgetary funds’ annual reports to be made public. The present procedures lack transparency and create an uncertain and inconsistent control and accountability environment.

51. **The Government should establish common budgetary, audit, control and reporting procedures which can be scrutinized, questioned and approved by the MOF, COM and Oliy Majlis (see Box 2).** To mitigate the performance risk, extra-budgetary funds should be consolidated in the state budget and operate the same processes of preparation, execution, reporting and control as the rest of the budget.

52. **The governance arrangements for the Road Fund should be reviewed in the light of recent institutional changes.** The main supplier to the Road Fund is Uzavtoyol, the state construction company from which the Fund was recently separated. Uzavtoyal is represented on the Management Council of the Road Fund and as such has a significant role in determining the Fund expenditures priorities, a clear conflict of interest. The Government could strengthen the contract-like relationship between the Road Fund and suppliers through an independent Management Council which specifies the resources provided and the performance expectations of the Fund. Governance could be improved still further if budget formulation and the determination of the priorities in the Road Fund were to become the responsibility of the appropriate sector ministry (Ministry of Transport and Communications).
Box 2: Improving Financial management of Extra-budgetary funds

In terms of financial management and control, extra-budgetary funds lie between the degree of oversight and control exercised by the Government over its budgetary entities and its public enterprises. Because they are important elements of the delivery of social services provided to citizens, increased transparency in the budget would provide important information to those most directly affected by the funds’ operation.

To minimize the risks outlined at the start of this section (particularly performance and financial risks) governments should minimize extra-budgetary funds. However, there are a number of intermediate steps that a government can take to minimize risk while rationalizing their utilization over time. These include having extra-budgetary funds:

- Included in annual budget documents on the same information base as the general budget (with supplementary reporting as appropriate to the particular fund);
- Subjected to the same MOF and Parliamentary scrutiny as on-budget spending;
- Meet common requirements for accounting, internal audit and control, and reporting;
- Record and report accounts on the same time frame and frequency as general budget and financial reports;
- Follow general principles of transparency in reporting and operation (e.g. regular reporting within Government and to Parliament, compliance with procurement, and contracting rules);
- Clear oversight authority; even if an EBF is established with an independent Supervisory Council, clear oversight responsibility should be given to a line ministry for sectoral policy issues and to MOF for matters relating to financial accountability;
- Subject to independent annual external audit.

Main recommendations

Short term (within one year)

53. **No new extra-budgetary funds should be created.** The existing smaller funds should be reviewed and where possible, re-integrated into the budget, with funding being made through standard budget allocations. At the same time the Government should build flexibility into virement procedures without recourse to MOF.

Medium term (one to three years)

54. **Extra-budgetary funds should be subject to the same rules as the rest of the budget.** All EBFs should be put under the aegis of a relevant sectoral ministry and they should be subject to the same rules for budget preparation, review and control. In particular choices on expenditure within the fund should be subject to questioning from the MOF and the COM as well as the Oliy Majlis.

55. **Extra-budgetary funds should be limited to the payments for paid services and not allow budget surpluses.** Extra-budgetary accounts should be limited to paid services or the collection of other specific fees. The practice of transferring surplus funds to extra-budgetary accounts (414 development accounts) undermines fiscal control and provides perverse incentives. If specific allocations are required for bonuses and staff incentives, these should be provided by budget allocations for these purposes. The issue of flexibility should also be dealt with by reducing the level of control of the Ministry of Finance on the expenditure tables for budget execution.
In the medium term extra-budgetary funds should be included in the treasury system for the purposes of managing cash. However this objective will be achieved only to the extent that the Treasury performs the budget execution function and extra-budgetary accounts are fully ring fenced within the Treasury. In such a control environment funds would be released once the authorizations have been made in accordance with clearly defined procedures. Handled correctly this reform would improve financial management without inappropriate limitations being placed on operational management\(^\text{12}\).

\(^{12}\) The Government envisages that within the framework of the Public Finance Management Reform Project the Treasury will perform the budget execution of extra-budgetary funds and the development accounts of budget agencies.
IV. PUBLIC SECTOR ACCOUNTING AND FISCAL REPORTING

Introduction

56. Under the Soviet central planning system accounting was an exercise in booking-keeping; budget reporting was merely a financial reflection of detailed production plans. Modern government accounting and financial reporting protect and manage public money and discharge accountability. Therefore good accounting practices support transparency in the use of funds and help clarify responsibilities in funds management. When governments engage in economic activity – be it buying or selling services or borrowing and lending money they are subject to economic accountability. When they levy and are in receipt of revenues they are subject to political accountability.

57. Accounting reforms should not been seen as an end in themselves but should be seen as tools for supporting the implementation of broader economic, political, and fiscal reforms within government. Having a broad view of stakeholder requirements in the context of a country’s socio-economic development is helpful in identifying priorities based on the priorities in the national economy. For example, changes to accounting and budgetary systems in the United Kingdom would have been more limited without pressure to restructure health and social welfare systems and reduce overall levels of taxation.13

58. Government accounting has three broad purposes which can be used to illustrate priorities in order to build full capacity into a government accounting system.14 The basic purpose of government accounting is to safeguard public money and prevent corruption. The intermediate purpose is to facilitate budgeting and planning of revenues, expenditures and debt management. At this stage officials go beyond score-keeping and use management and cost data to conduct government operations in a more economical, effective and efficient manner. Finally the advanced purpose of government accounting is to help government discharge its public accountability. At this stage the emphasis of accounting shifts from bureaucratic control to accountability reporting to the public. It is not enough for government officials to keep accurate books and records – they are open to the public through transparent and comprehensible financial statements.

Current accounting arrangements

59. Government accounting in Uzbekistan is based on the Soviet accounting system which uses many concepts of modern accounting including accrual measurements and double entry bookkeeping. In addition Uzbekistan has a large number of bookkeepers who are trained in these concepts and are proficient in their application. However, there are significant capacity constraints which hinder the development of a modern system of accounting and financial reporting. The accounting systems used at a central and local government level are predominantly manual. There is no central management information system; significant reliance is placed on banking records and computer spreadsheet packages.

60. **All budget organizations prepare monthly, quarterly and annual reports on budget execution.** Republican budget institutions submit their financial reports to higher level units, which then consolidate and submit reports to the MOF. Regionally financed budget institutions submit financial reports to higher finance departments where they are consolidated and submitted to regional finance departments. These are further consolidated and submitted to the MOF. Budget accounting is prepared on a cash basis, although some additional accruals information is provided in accordance with the stipulated order. Separate charts of account are prepared for cash releases to line ministries and regional finance departments.

61. **The framework of government accounting contains some weaknesses, limiting its use for the three purposes mentioned above.** The MOF and regional and local government finance departments operate a cash-based chart of accounts, while budget institutions use a quasi-accrual based accounting system which does not meet international standards. The MOF cash accounts are inaccurate in that they do not report the final disposition of cash deposited in the bank accounts of line ministries/departments and finance departments of regional and local governments. Current laws specify broad responsibilities of all parties and the processes to be followed in accounting and financial reporting. However, the regulations need updating to address fundamental weaknesses highlighted in previous reports\(^\text{15}\) (See Box 3 above).

### Box 3: Key weaknesses of the government accounting system and their impact on reporting and decision making

- Expenditure accounting in MOF is based on the financing transferred to line ministries. This corresponds neither to accrued expenditures nor to the final disposition of cash;
- MOF cannot systematically monitor and report on arrears because of the timing gap between the recording of the verification stage of transactions in the MOF accounting system and budgetary institutions. Payables information is provided by budgetary institutions through their parent organizations once every quarter. This is inadequate, particularly in an environment of frequent cash shortages;
- MOF and regional finance departments do not follow consistently defined principles for matching revenues to expenses within a reporting period. This distorts the reporting of budget entities;
- The MOF does not analyze and report contingent liabilities and guarantees, including those that are expected to be called in during the year. There is a need for more comprehensive information about the real level of government’s liabilities, relating to both debts and other obligations;
- There is inadequate recognition of materiality in recording transactions and events. For example the threshold value for capitalization of transactions pertaining to fixed assets is either too low or non-existent;
- The annual execution report is not subject to an independent audit to legitimize the reliability of financial reporting presented to Parliament.

**Government accounting – the introduction of modern accounting and financial reporting system**

62. **The introduction of the Treasury permits prompt and relevant reporting.** The establishment of the Treasury with a single account processing all payments and receipts allows for consolidated, consistent and timely reporting of central government, line ministries

\(^{15}\text{See for example PDP, loc cit, Annex 9.}\)
and local governments expenditures and revenues for decision making. This will enable policy makers and institutions to respond in a timely manner to changes in the fiscal environment. It would also enable regular reporting to the public and parliament, thus enhancing accountability and transparency.

63. The proposed accounting and financial reporting reforms are ambitious but well thought out. The phased development of modern public sector accounting and financial reporting as an integral part of the treasury reforms and based on recognized international standards is an approach which could promote greater accountability and transparency (see Box 4). Few countries in the world have adopted full-accruals accounting and this should be viewed as a long term goal. The initial focus should be on a well functioning treasury system with accurate reporting of cash supplemented by accrual on payables, receivables and financial assets and liabilities. The Government should ensure that technical reforms do not get ahead of institutional reforms and implementation capacity.

**Box 4: Proposed development of government accounting standards**

The government intends to gradually introduce government accounting standards using IFAC International Public Sector Accounting Standards (IPSAS) and in compliance with GFS 2001 recognition principles. The plan proposes a move from cash to accruals following the path outlined below:

- The first phase is to apply the Uzbekistan Government Sector Accounting Standard (UzGSAS) for Cash which complies with the IPSAS Cash Accounting Standard. During this phase the MOF intends to introduce a budget classification and Chart of Accounts compliant with GFS 2001 and international accounting standards.

- In the second phase the government will develop standards for accounting and reporting of payables, receivables, financial assets and liabilities (*modified accrual accounting*). These reforms will follow the introduction of the Treasury system and introduction of the GFMIS (presently planned for 2007).

- In the final phase full accrual accounting will be implemented which provides for accounting and reporting of non-financial and contingent assets and liabilities.

64. **Communicating the rationale benefits of the accounting and financial reporting reforms can begin immediately.** Currently financial reporting in Uzbekistan has an audience which is limited to technical financial specialists. The use of financial reporting as a basic tool of managerial decision making and accountability within government should be an integral part of the strategy of communications and training carried out in parallel with the treasury reforms. The MOF, local finance departments and bookkeepers need basic training in the proposed public sector accounting and financial reporting reforms. Later, during implementation there will be a need for detailed training, the development of manuals and user guides to assist finance staff in their work.

65. **Independent audit of the annual budget execution report will enhance credibility and further increase transparency.** This should be a medium to long term goal once the government has introduced internationally recognized standards and enhanced the capacity of the external audit function (see also section VIII of the CFAA).
66. **Communicating the rationale benefits of the accounting and financial reporting reforms can begin immediately.** Currently financial reporting in Uzbekistan has an audience which is limited to technical financial specialists. The use of financial reporting as a basic tool of managerial decision making and accountability within government should be an integral part of the strategy of communications and training carried out in parallel with the treasury reforms. The MOF, local finance departments and bookkeepers need basic training in the proposed public sector accounting and financial reporting reforms. Later, during implementation there will be a need for detailed training, the development of manuals and user guides to assist finance staff in their work.

67. **Independent audit of the annual budget execution report will enhance credibility and further increase transparency.** This should be a medium to long term goal once the government has introduced internationally recognized standards and enhanced the capacity of the external audit function (see also section VIII of the CFAA).

**Main recommendations**

**Short term (within one year)**

68. Treasury GFMIS User Requirement Document (URD) should confirm the Government’s commitment to accounting reform process outlined above.

69. The government should train users and providers of financial information on the benefits of public sector accounting and financial reporting. **This training should be conducted as an integral part of communicating the goals of the treasury reforms.**

**Medium term (one to three years)**

70. Continue phased development of accounting and reporting standards.

   i) Cash elements of the new accounting standards;
   ii) Accrual elements of the accounting standards added together with accounting policies;
   iii) Replacement of old quasi-accruals accounting instruction with instruction based on international standards

**Long term (over three years)**

71. **The annual budget execution report should be subject to audit once the cash accounting standard is implemented.**

72. **Consider the development of full-accruals accounting** based (i) on evaluation of the experience to date in Uzbekistan and (ii) experience of accruals accounting in other economies in transition.
V. SELECTED REVENUE ADMINISTRATION ISSUES

Introduction

73. Revenue administration arrangements have an important impact on the management of the government’s liquidity position and the availability of cash to carry out government policy decisions. Adequate financial management arrangements require comprehensive systems and institutional arrangements both to formulate tax and tariff policies and processes to administer and collect tax and non-tax revenues. Accounting information systems should provide both aggregated information to enable the efficient management of cash and disaggregated regional, sectoral and taxpayer information to monitor and control tax compliance.

74. The focus on this brief section is on selected areas of revenue collection which impact on the effectiveness of fiscal and cash management. Especially the following matters are discussed:

- Institutional issues - the extent to which the organization of policy and collection agencies assists in the efficient and effective management of revenue and overall cash management;
- Prompt collection of all revenues – no unreasonable gap between date due and actual collection;
- Adequacy of revenue monitoring - as part of overall budget monitoring and cash management;
- Auditing procedures for revenues.

75. Tax levels in Uzbekistan continue to be relatively high at 25.7 percent of GDP, compared to the average rate of 22 percent in the CIS, although there is a gradual downwards trend. The tax legislation is very complex, and it is frequently revised. A breakdown of the tax revenues for the period 2002 and 2003, together with the 2004 budget is shown in Table 2 below. The CFAA does not cover issues of tax policy or tax administration in great detail; these have been addressed in previous Bank reports from which this section has been drawn and updated.

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Table 3: Revenues of the State Budget of Uzbekistan (Million soums)

<table>
<thead>
<tr>
<th>Component</th>
<th>2002 Actual</th>
<th>2003 Actual</th>
<th>2004 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues, excluding Special Funds</td>
<td>1,864,111</td>
<td>2,342,141</td>
<td>2,621,300</td>
</tr>
<tr>
<td><strong>Of which</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>1. Direct Taxes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on revenue (profit) of legal entities</td>
<td>173,967</td>
<td>210,522</td>
<td>182,186</td>
</tr>
<tr>
<td>Gross profit tax on trade and catering enterprises</td>
<td>N/a</td>
<td>N/a</td>
<td>75,500</td>
</tr>
<tr>
<td>Unified tax from microfirms and small enterprises using simplified taxation system</td>
<td>66,272</td>
<td>86,752</td>
<td>85,771</td>
</tr>
<tr>
<td>Tax on income of individuals</td>
<td>230,506</td>
<td>288,272</td>
<td>334,203</td>
</tr>
<tr>
<td>Fixed tax on revenues of individuals and legal entities involved in entrepreneurial activity</td>
<td>34,752</td>
<td>31,399</td>
<td>36,427</td>
</tr>
<tr>
<td><strong>2. Indirect Taxes</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VAT</td>
<td>447,490</td>
<td>535,760</td>
<td>604,270</td>
</tr>
<tr>
<td>Excise Tax</td>
<td>492,043</td>
<td>693,623</td>
<td>751,567</td>
</tr>
<tr>
<td>Customs Tax</td>
<td>29,354</td>
<td>40,964</td>
<td>60,745</td>
</tr>
<tr>
<td>Unified customs payment from individuals</td>
<td>24,328</td>
<td>45,149</td>
<td>68,152</td>
</tr>
<tr>
<td>Tax on use of gasoline, diesel oil and gas for vehicles from individuals</td>
<td>25,081</td>
<td>38,304</td>
<td>48,210</td>
</tr>
<tr>
<td><strong>3. Resource payments and property tax</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property tax</td>
<td>34,254</td>
<td>71,435</td>
<td>74,317</td>
</tr>
<tr>
<td>Land tax</td>
<td>37,798</td>
<td>51,428</td>
<td>76,167</td>
</tr>
<tr>
<td>Tax on use of depths</td>
<td>18,306</td>
<td>29,807</td>
<td>43,295</td>
</tr>
<tr>
<td>Tax on use of water resources</td>
<td>6,434</td>
<td>8,777</td>
<td>12,146</td>
</tr>
<tr>
<td>Environmental tax</td>
<td>42,465</td>
<td>60,818</td>
<td>54,176</td>
</tr>
<tr>
<td><strong>4. Municipal improvement and social infrastructure development tax</strong></td>
<td>39,666</td>
<td>40,708</td>
<td>45,734</td>
</tr>
<tr>
<td><strong>5. Other revenues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>II. Revenues of special funds</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Off-budget Pension Fund, Republican Road Fund under the Ministry of Finance, Employment Encouragement State Fund, Special Account of the State Property Committee)</td>
<td>637,000</td>
<td>830,206</td>
<td>936,387</td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td>2,501,111</td>
<td>3,172,347</td>
<td>3,557,687</td>
</tr>
</tbody>
</table>

Organizational Structure of Tax Administration

76. The organizational structure of tax administration in Uzbekistan is fragmented (a summary of the institutional arrangements is shown in Box 5). Like many other countries in the region, different departments are organized by function, type of tax, and type of taxpayers, with overlapping and often conflicting responsibilities. To improve the tax administration’s operating efficiency, a new structure might be created along functional lines. This would include departments for key tasks such as returns filing and payment, collection enforcement, audit, appeals, and taxpayer services. Subsidiaries in large corporate groups, including large public enterprises report to local tax offices rather than being handled centrally in one tax office. Previous reports have suggested that, in order to improve efficiency and capture all revenue income, special offices could also be established to administer and control the largest taxpayers.
Box 5: Institutional Arrangements for Tax Policy and Administration in Uzbekistan

The tax code specifies that special rates on profit taxes, excise taxes, and local taxes are set by the Cabinet of Ministers (COM). The tax policy department of the Ministry of Finance (MOF) has primary responsibility for direct taxes and the majority of indirect and property taxes. It defines the overall tax policy, determines tax rates, drafts tax legislation and submits proposals through the MOF to the COM.

The Budget Department in MOF performs the revenue accounting and forecasting functions. It receives revenue receipt information from tax collection agencies and provides revenue forecasts for use by the Tax Policy Department.

Tax collection is the responsibility of the State Tax Committee (STC) and the State Customs Committee (SCC), who are both subordinate to the COM. Approximately 85 percent of the taxes are collected by the STC. These include receipts from profit tax, income tax, value added tax and excise tax. The SCC collects about 13 percent of tax revenue, with the rest coming from other sources. The STC has offices in each Rayon and Oblast, while the SCC has 180 customs posts manned by 1,400 customs officers along the border and in major airports.

The Chairman of the STC, SCC and Minister of Finance all report to the Deputy Prime Minister in the COM. The STC and MOF discuss issues of mutual concern through a Council of Experts. The Council rarely meets, and that communications between either of the two revenue agencies and the MOF must follow a chain of command up through the respective Chairman of the State Revenue or Customs Committee to the Deputy Prime Minister to the Minister of Finance, the appropriate MOF Deputy Minister and then to the official to whom the message is to be delivered.

Accounting, reporting and control of revenues

77. Communication between the collection agencies and Ministry of Finance is improving. The collection agencies have developed a matrix of management reports which are provided to the tax policy department of the Ministry of Finance. However the present information systems preclude the provision of useful information which would enable more detailed analytical work on tax policy and processes.

78. Collection agencies are investing in information technology. To increase the timely information flow, the tax authorities have been investing in the development of management information systems. STC has a unified collection system which links local, oblast and Headquarters through satellite. SCC is investing $24-$27 million to develop and implement unified management information system throughout Uzbekistan. Legal entities have a unique tax identification number and all citizens over 18 years old also have a unique taxpayer identification number. A step forward in the efficient use of information technology is the Presidential Decree allowing the use of electronic signatures with effect from January 1, 2004.17

79. The complexities of tax policy may discourage compliance. In common with other transition economies Uzbekistan faces a major challenge in enforcing existing tax policy without stifling the development of legitimate economic activity. One crude measure of the acceptance of the tax regime by taxpayers is the amount of tax collected through the courts or administrative enforcement orders. One estimate, provided by the Ministry of Finance indicated that between 11 and 15 percent of taxes are collected through these mechanisms. This creates both an administrative burden on the tax administration system and creates a cash flow problem due to the gap between the due date and actual collection of tax revenues.

80. The commercial banking system continues to act as a tax enforcement mechanism. While tax collection is a normal function of commercial banks, tax enforcement is not a recognized function and undermines confidence in the financial system. With the support of a US Treasury Advisor the Government has developed an amendment to the Tax Code which would restrict access of the STC to banking information of taxpayers. Under the draft legislation banks would have to respond (i) to an encashment order, signed by the Head of the local STC or (ii) to a tax demand issued by a Court. This is an important piece of legislation which would contribute to building confidence in the banking sector of the Uzbek economy.

81. The efficiency and effectiveness of revenue enforcement mechanisms could be enhanced through further capacity building. The structural and enforcement arrangements carried out by the Control and Revision Unit of STC is described in Box 6 below. The Committee has started some work on developing risk-based IT systems to identify high-risk taxpayers. The early pilots have been hampered by a lack of automated data and the overall complexity of the tax regime in Uzbekistan. The Committee would benefit from technical assistance to develop skills and audit tools relevant to their needs.

**Box 6: The Control and Revision Unit (CRU) of STC**

The Control and Revision Unit is the main tax inspection unit within the STC. The main function of CRU is to ensure that taxpayers comply with existing tax legislation. This work is carried out mainly through on-site visits to taxpayers. The Unit has approximately 250 staff; 24 staff based at Headquarters in Tashkent; an average of 8 staff in each oblast and 3 staff in each rayon.

CRU conduct their inspections according to an annual audit plan which receives input from the rayons and oblast tax offices. Taxpayers receive on-site visit every two years although more frequent visits can be conducted if they are included in the annual plan agreed with the Republican Coordination Committee (RCC). CRU also conducts ad-hoc inspections based on the COM resolutions, also coordinated through the Republican Coordination Committee.

According to CRU 75 percent of inspections result in penalties which arise (i) through late payment of taxes or (ii) inaccurate financial statements which form the basis of the tax assessment.

**Main recommendations**

**Short term (within one year)**

82. Implement the proposed amendment to the Tax Code which would restrict access by the State Tax Committee to banking information on taxpayers.

**Medium term (one to three years)**

83. Simplify the number of taxes and reduce the number of exemptions. The complexity of the present code is the core reason for poor tax compliance in Uzbekistan and stifles private sector activity.

84. Capacity building program for enforcement agencies. Develop risk-based model to manage revenue enforcement. Identify IT requirements for auditing based on risk model and selected audit tools. Develop training program for managing risk and audit of taxpayers based on other countries experience.
VI. INTERNAL CONTROLS AND INTERNAL AUDIT

Introduction

85. In many transition countries internal control and internal audit have traditionally been synonymous. Internal auditors are found in a control directorate, at the centre of government (typically the MOF) and sometimes in spending ministry headquarters. They are agents of financial control, whose objective was to ensure that all transactions of the entity were legitimate and in compliance with relevant rules and regulations. This is performed through centralized, top-down control activities over budget organizations.

86. Top-down internal audit which focuses on compliance issues does not support managers in budgetary institutions in establishing, maintaining and being held accountable for the internal control environment. That responsibility defaults to the state financial control unit under responsibilities established in law or resolution.

87. There is increasing international consensus on the approach to public sector internal control and audit. Modern internal control frameworks begin with a proposition that it is management’s responsibility to establish and maintain an adequate internal control regime (see Box 7 below). The role of financial management is facilitating the delivery of services and in the effective utilization of resources. To do so government agencies need internal control systems which encompass governance, and a strong and ethical internal management culture. The role of the internal auditor to provide independent and objective advice to management on the effectiveness of their controls and to make recommendations as to how the controls can be improved.

Box 7: Three main features of a modern internal control systems

1. The identification of areas of risk, including:
   - Misuse or waste of financial human and technical resources;
   - Failure to execute budget and other policy decisions (of a financial and non-financial nature) in compliance with rules;
   - Uneconomic and inefficient administration;
   - The failure to maintain complete, accurate and timely accounting records;
   - Fraud and corruption;
   - Failure to provide timely and reliable financial management information.

2. The establishment of internal control systems to address these risks; these may be based in law, policies or procedures. Financial controls are a significant component of management controls.

3. The establishment of a modern internal audit function to check the internal control systems, to identify gaps and to recommend corrective action by management.

88. Moving to models of control in line with international norms will be a challenging yet important long term reform. Experience in other former Soviet countries has shown that extensive time and effort is required to provide a basic understanding of concepts such as

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18 IFAC, INTOSAI and the IIA all provide guidance and international standards for internal control and audit.
internal control, oversight and auditing. As discussed elsewhere in the Report, the timing and sequencing of the institutional framework of internal control should be related to broader economic, political and fiscal reforms. The next section of the Report provides a general overview to the public sector internal control environment and then explores the institutional arrangements for internal audit in Uzbekistan.

Current systems of internal control in Uzbekistan

89. The present system of budget execution results in a loss of budgetary control. The absence of a modern treasury with an appropriate scope and a classification and information system to provide timely and accurate financial information is a critical control risk. As a result, there is no overall system of cash management and cash appropriations are held in numerous government bank accounts over which there is little direct control.

90. The fragmented control environment creates the possibility of significant liabilities, both actual and contingent, in the Government’s extra-budgetary funds, public enterprises and joint ventures. Few, if any, enterprises have separate internal audit units and the governance and transparency of government agencies need to be reformed. The present governance framework is incapable of adequately monitoring and controlling these entities.

91. Reforms which can address some of the above weaknesses are being undertaken by the Government. These include the establishment of the new treasury law, the new Treasury organization within MOF, a common classification system that is GFS 2001 compliant, the establishment of a single treasury account, modified payment processes and supporting reporting formats. The Government is to adopt a centralized treasury model. Oblast and Rayon treasury offices will be centrally controlled by the MOF Treasury department and supported by the Financial Management Information System (FMIS).

92. Roles and responsibilities should evolve and become clearly defined through the treasury reform process. MOF’s role should become more focused on monitoring and evaluation of the budget and setting government wide standards for financial management systems, including internal control and audit. In this environment budget entities should assume full accountability for the formulation and execution of their planned budgets, including the maintenance of a system of internal control.

Towards an Improved Regime of Internal Control

93. A number of treasury reforms proposed by the Government have the potential of improving the internal control environment within the public sector (See box 8 below).
Box 8: Important reforms to improve public sector internal controls

- Completion of the unified Chart of Accounts and its implementation for the 2005 budget;
- Passage of the Treasury Law and its establishment as a separate unit within the MOF in 2004;
- Installation of the FMIS to provide the Treasury with systems to conduct its activities associated with the management and control of the TSA (currently scheduled for completion in 2007);
- Develop reporting systems to enable MOF to monitor rather than conduct detailed controls over budget execution.

94. The separation of duties is a fundamental aspect of financial control. The establishment of a treasury responsible for payment processing duties separate from the origin of the payment (budgetary institutions) is of fundamental importance. In order to maximize the benefit for financial control of the establishment of the treasury, its role in controlling the regular payment orders should be maximized. This is especially relevant in that one of the reasons for the establishment of the treasury is the weakness in control over budget execution exercised by commercial banks.

95. The Treasury should have responsibility for confirming that all the elements of a payment order are correct. This implies giving Treasury powers to obtain information from budgetary institutions, including the right to withhold payment in the event that irregular payment orders are suspected with good cause. This requires shifting institutional responsibility for ex-ante control from the Control and Revision Unit (CRU) of MOF to the Treasury (see further discussion of the role of CRU below).

96. While developing new financial controls the reforms should be linked to measures which give budget institutions more flexibility in making spending decisions. In particular reducing the level of control through expenditure tables. This should be achieved by reducing the level of detail in the budget tables and allowing greater scope for virement without reference to the MOF.

97. In conclusion the medium term goal of MOF should be able to progressively modernize the internal control environment within government through the new institutional arrangements. However, this is a complex long-term reform which involves realigning institutional arrangements which convey power and prestige.

Institutional arrangements for financial control – the role of the Control and Revision Unit

Introduction

98. Presently, there is no public sector internal audit function Uzbekistan. The institution charged with conducting internal financial control is the Control and Revision Unit of the Ministry of Finance (CRU). Within the Former Soviet Union CRU was charged with ensuring compliance with delegated budget authority and associated laws and decrees. One of the challenges in developing decentralized systems of internal control in line with international norms is to convert CRU into a modern internal audit function.
99. After the introduction of the new Treasury function responsibility for ex-ante expenditure controls will shift from CRU to the Treasury function. Treasury staff, assisted by the new FMIS, will be able to exercise the ex-ante expenditure approvals for commitments and payments. In the medium term CRU will have to change its role and functions. In the longer term the Government will wish to address how to develop a decentralized internal audit function which is supportive of management in line ministries and budgetary organizations.

The Control and Revision Unit of the Ministry of Finance (CRU)

100. The scope of CRUs work is narrow when benchmarked against international standards of internal audit. Its focus is principally on the identification and quantification of the misuse of public funds and ensuring that they are returned to the budget (see box 9 below). While this function is important the medium to long-term goal should be to develop a modern decentralized internal audit function which is supportive of the treasury reforms.

101. The narrow scope of the CRU’s present control activities is reinforced by its own measurement of performance. While this task is crucial, inspectors have little incentive to identify broader issues such as weaknesses in internal controls or potential improvements in administrative efficiency. If these issues were addressed, it would improve the long-term development of budget organizations and could be used as an additional measure of overall institutional performance.

102. Salaries and incentives within CRU should support the overall goals of the treasury reform. The Ministry of Finance is allowed to retain 10 percent of funds returned to the budget through the activities of CRU. These are placed in a Special Fund of which 25 percent is available for salary enhancements to MOF staff and 75 percent for capital projects within the Ministry. Base salaries for CRU staff are in line with other public servants; however CRU staff can earn up to two times their regular salary based on results and overall performance. In the medium to long term incentives for CRU staff should be based on the primary and boarder objectives of improving systems of public sector financial management rather than the maximization of receipts.

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19 According to its Management, in the last fiscal year (2003) CRU has, through on-site visits uncovered irregularities amounting to 600 million soums (0.2% of the state budget) in unauthorized or excess expenditure, the majority of which has been returned to the budget.
Box 9: The Control and Revision Unit of the Ministry of Finance (CRU)

Introduction and scope of work

The MOF Control and Revision Unit currently have 860 staff. There is 63 staff in Head Office with the remainder based in 14 regional departments, in the Republic of Karakalpakstan, and the City of Tashkent. The regional offices are subordinated to the Head Office in Tashkent and operational departments broadly mirror its structure. The CRU performs three main functions:

At the start of the budget calendar, CRU reviews the allocation of budget resources through budget tables to budgetary institutions;

- Ex-post audit of individual budget entities to ensure that budgets are executed in accordance with the registered budget tables. This function is carried out primarily through site visits by CRU local staff;

- Ex-post audits of the execution of the oblast level budgets by CRU staff from head office. These audits are conducted according to an annual plan and involve a combination of site visits at major spending units in the oblast. The audit team for these visits typically numbers 10-15 staff.

Capacity issues

The average age of CRU staff is 35-40 and the majority has a degree in finance or economics. Management aim to recruit graduates who have experience in the budgetary systems of Uzbekistan.

The CRU has made efforts to build a performance evaluation system to assess the outputs, quality and results of their inspectors. Although the Report did not have an opportunity to evaluate this system in depth, it would appear to be quite rigorous; according to CRU management, 250 out of 550 professional staff put through the evaluation process received unsatisfactory grades. The Team was advised that approximately 10-12 staff is expelled each year for misconduct, and a further 40-50 are subject to administrative discipline which results in fines and/or warnings.

CRU holds annual training courses which cover legislative changes and inspection methodology. Their staff has had few opportunities to learn modern audit methodologies and would benefit from technical assistance in all aspects of modern internal audit.

Towards a modern internal audit function

103. Modern public sector internal audit functions as a service to management, providing it with assurance that its internal control systems are functioning effectively. The focus of internal audit is the set of risks which internal control systems are designed to mitigate, and it follows well-developed internal audit principles and procedures.

104. The experience in developing modern internal audit functions in FSU has been disappointing. First, the agencies such as CRU are a source of institutional power that finance ministries are often reluctant to relinquish for a more decentralized management model. Second, a CRU is limited in the scope and effectiveness of its control activities by insufficient human resources and a lack of supporting information systems. Thirdly, basic concepts of internal and external audit do not fit comfortably in existing governance frameworks; they need to evolve in parallel with other reforms. Finally, in common with the rest of the public sector in Uzbekistan, the low level of salaries makes it difficult for the CRU to attract and retain staff with the expertise and skills necessary to develop a modern internal audit function.
105. **Uzbekistan needs to sequence changes to the internal audit function which take into account the limited institutional capacity to implement reforms.** The recent IMF FAD Report\(^{20}\) recommended a first step towards establishing a modern internal audit system - the establishment of an internal audit function in the new Treasury unit. A key role of the internal audit department would be to strengthen the role of the Treasury, thereby strengthening the entire financial control system. This internal audit unit should operate according to international internal audit standards.\(^{21}\) It could operate in a complementary manner to CRU, but there would be regulatory provisions to ensure roles and responsibilities were well defined. During the selection of staff into the Treasury internal audit department’s staff transfers from CRU should be particularly carefully managed to ensure that only adequately qualified, motivated and competent auditors are recruited into the Treasury.

106. **In the medium to long term CRU’s role might evolve into a centralized internal audit unit.** It would operate on behalf of all budget entities that do not have internal audit units and perform its audits in conformity with international internal audit standards. Clear criteria must be developed to specify their roles and accountabilities. The creation of the treasury system will affect the long term staffing requirements for internal audit. In setting up the new Internal Audit Department it would be important to ensure that appropriate selection criteria are set for the competences required from professional internal audit staff.

**Main Recommendations**

**Short term (within one year)**

107. Endorse the recommendations of previous studies that an internal audit team be created within the new Treasury directorate, using staff from the CRU that has the required abilities to become the internal auditors for all Treasury operations.

108. Develop and implement a long-term strategy to bring its internal control framework into compliance with international standards. This should provide a roadmap to develop the necessary legislative and structural changes to accomplish it.

**Medium (one to three years)**

109. Develop a long term staffing plan applicable to; (1) the Treasury Internal Audit Department (IAD) and; (2) the modified CRU within the MOF.

110. Set minimum requirements for the competence and skill requirements of the Treasury IAD.

111. Solicit donor support for professional development programs and training to allow CRU and Treasury IAD staff gain familiarity with international aspects of public sector accounting, internal control and auditing.

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\(^{21}\) Extensive guidance on the possible governance arrangements, the role of Treasury IAD and a sample internal audit manual have been provided in the *draft Public Financial Management Reform Project*, PDP Report – September 2003, Annex 10.
Long term (over three years)

112. Include specific new or amended legislation beyond that establishing the Treasury function, in order to:

- assign authority and responsibility to the Minister of Finance for the establishment of an effective internal control and audit framework in the Government;

- redefine the respective roles and responsibilities of CRU and Treasury Internal Audit Department;

- require the creation of internal audit units in all major budget entities;

- authorize the creation of a modern, standards-based internal audit unit within the MOF. MOF CRU should be converted into a central internal audit unit, resident in MOF, performing audits across all budget entities that do not have their own internal audit units.

- vest authority with the Minister of Finance to establish the qualifications, training, certification, audit and reporting standards, policies and guidelines that would apply to all internal auditors in the Government.
VII. EXTERNAL AUDIT

Introduction

113. Auditing, together with internal controls and monitoring processes and mechanisms are part of the essential checks and balances over the use of public resources in government. Effective external audit provides an independent assessment that the overall objectives set by Parliament and government are being met and gives assurance as to the overall quality of public expenditure and the management of public assets and liabilities. Without this assurance there is a risk of flawed information, mismanaged resources and that policy decisions are ignored by operating units.

114. The fundamental distinction between external and internal audit pertains to the degree of independence of the auditor in relation to the audited entity and to whom the audit report is addressed. To be effective and objective in their audit work the external auditors should be fully independent from the audited entity and their audit reports should be addressed to entities separate from the bodies being audited. The differentiation between internal and external audit should not preclude close cooperation between the two functions as they carry out their respective responsibilities.

115. Fundamental principles of auditor independence cause difficulties in the context of the present institutional and constitutional arrangements in many CIS countries. This should not preclude the short to medium term development of an audit institution which provides additional assurance to the COM, Parliament and public over the use of public funds.

116. International standards issued by International Organization of Supreme Audit Institutions (INTOSAI) provide guidance on the legislative base for external auditors. These include audit independence, objectivity, standards to guide the conduct and reporting of audits, training of external auditors and quality control processes.

Progress on the development of a Supreme Audit Institution

117. To date limited progress has been made on the development of an independent SAI. Previous diagnostic reports recommended the establishment of an independent Supreme Audit Institution (SAI). The Parliamentary Committee on Budget, Banking and Financial Issues has also recognized the need for such a function to fulfill its budget oversight function.

118. In 2002 a Chamber of Accounts (COA) was established within the President’s Office. The Chamber is accountable both to the President and the Oliy Majlis, and is to be “an independent organ, independent and objective in its assessments”. Although the COA lacks a number of the attributes of an external audit function, it could be developed into one. The COA currently has nine staff and is managed by a Collegium (Board) of ministers that meets twice annually. Currently it uses CRU and revenue inspectors from other entities to provide the resources required to perform its work program. In September 2004, it has

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22 For more information see INTOSAI website www.intosai.org
24 Presidential decree # UP 3093 (21 June 2002) as amended by Decree # 3157 (4 Nov 2002).
acquired expanded office space in the new Senate building, as a first step towards increasing its staff. These audit reports are not published, nor are they tabled in Parliament.

119. **A limited number of audits are being performed.** The COA is carrying out a limited number of compliance audits focusing on the execution of the state budget. The scope of COAs work program is limited by a lack of staff. Consequently the annual audit coverage (percentage of budget funds subject to COA audit) is extremely low.

**Main Recommendations**

**Short term (within one year)**

120. The COA does not meet the INTOSAI criteria for independence, nor does it follow international auditing standards in the course of its audits. It is, however, a nascent external audit function, and could become the foundation for the development of an acceptable state audit organization. A short-term development plan might cover the following steps.

**Step 1 - Establish the Legislative Base.**

121. **The COA should establish a legal basis for its activities.** The COA should seek technical assistance from donors to provide international experts to assist in the preparation of a draft law. The Government should ensure that the provisions in the draft law require that the Chamber of Accounts report to the Budget and Finance committee of the Oliy Majlis25.

122. **At this embryonic stage of its development, the dual reporting relationship to the President and Parliament may provide both the authority and protection for the COA as it conducts its work.** Dual reporting could be continued until the function has matured and its role is established across Government. The long term goal should be for the COA to report directly to Parliament.

123. **The new law on the Chamber of Accounts should be passed by the government and approved by the Parliament** before the constitutional changes come into effect in January 2005.

**Step 2 – Increase transparency and disclosure of audit work.**

124. **Currently neither the annual audit program nor the audit reports of the COA are available to the Oliy Majlis or the public.** Internationally the requirements for the distribution of audit reports are often specified in the laws establishing the SAI. SAIs is usually required to submit all reports to Parliament and most have considerable discretion in the distribution of their findings.

125. **In many countries audit reports are available to the public unless restricted for reasons of national security.** In a democracy the general public has a legitimate interest in the results of the audits of public entities and the use of public funds.

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25 During the CFAA Mission there was considerable confusion regarding the reporting relationship between the COA and the budget institutions set up within the bicameral Parliament (Oliy Majlis and Senate). This needs to be clarified through the process of drafting the legislative base for the COA.
Step 3 – Resource Chamber of Accounts, recognizing limited capacity to absorb new concepts.

126. **A qualified and eminent finance professional should be appointed as President of the COA.** This appointment should be made under the same terms as the Constitution provides for the appointment of other senior independent positions (e.g. President of the Supreme Court).

127. **The COA should conduct staff recruitment based on clearly defined skills and competences, many of which are new to auditors in Uzbekistan.** Staff should have the necessary education and experience to learn modern auditing techniques that conform to international auditing standards. The COA should develop a capacity development program which recognizes that in the short term it will have limited capacity to absorb new concepts and techniques.

**Step 4 - Enlist Support from the International Community.**

128. The Chamber of Accounts should build links and organize training events with other SAIs in developed countries so that they can learn from their experience. The Government should initiate discussions with the international donor community in order to arrange funding for peer support from SAIs that have already completed the transition to a modern external audit function.

**Medium term (one to three years)**

129. **Develop skills in financial attestation audits.** As noted above the COAs current work is focused on compliance auditing; reviews of individual transactions after the fact, to ensure that appropriate authorizations and documentation are present. Modern ex-post financial audits are broader in nature and involve an attestation of the financial accountability of government entities, involving the examination of financial records and the expression of an overall opinion on the financial statements. These audits are new to the public sector and the COA should develop these skills steadily over time with the support of international expertise. Initially the COA should carry out a number of pilot audits and closely monitor the process and the results of this work.

130. **Define and build reporting lines to Parliament.** The COM is likely to influence the work program of the COA in Uzbekistan in the medium to long term; however this should not preclude the development of reporting lines to Parliament. For example the audit reports could be sent to the Budget and Finance Committee and management of the COA could appear before the Committee. Creating this relationship would increase the transparency and credibility of the mandate of the COA.

**Long term (over three years)**

131. **Conduct an audit of the annual budget execution report.** The COA should plan to conduct an audit of the annual budget execution report when the Government first prepares financial reports based on internationally recognized public sector accounting standards (see also Section IV of the Report.)
VIII. PUBLIC ENTERPRISES

Introduction

132. Public enterprises are not part of the definition of general government in Uzbekistan. However, they conduct transactions that can have significant fiscal implications for the Government. These include the payment of dividends, the receipt of budgetary subsidies to cover losses, debt interest payments or loan payments due, the receipt of public loans or guarantees, and liabilities that can be a source of contingent liability for the Government.

133. Building a framework for oversight and monitoring the activities of public enterprises is an important element of a country’s framework of financial accountability. The key elements are: (1) improving systems of corporate governance, financial reporting and auditing in enterprises; (2) developing the monitoring and oversight functions within Government, and (3) increasing the availability and transparency of information to Parliament and public.

Framework of oversight for public enterprises in Uzbekistan

134. Uzbekistan has a large and complex web of corporate structures and institutions. In Uzbekistan the executive branch of Government consists of ministries, state committees and agencies. At the sub-executive level, there are agencies, which consist of former sector ministries that have been partially privatized and allowed to operate on a quasi-commercial basis. The executive has substantial ownership interests in public enterprises, as there has been little privatization of large enterprises. The country does not have an overarching state corporation’s law and many of the state enterprises are regulated by Presidential Decrees and have Charters and Resolutions approved by the COM. The governance arrangements for the use of state powers are only partially defined, as the constitution does not formally specify the powers of executive bodies and ministries, state committees, and associations; and they can all issue directives that have the force of law.

135. Information on the exact number of state owned enterprises is difficult to obtain. In addition to the public enterprises, there are also approximately 8000 enterprises without corporate form, an inheritance of the country’s Soviet past. Examples include hospitals, clinics, kindergartens, and other public service entities. The difficulty in compiling a complete inventory is compounded by the definition of what constitutes a public enterprise. The Government restricts this category to those that are 100 percent owned by the State. Any dilution of this ownership by entities other than the State Property Committee places them in the Joint Stock Company (JSC) category, even if the shareholder is another state entity. In reality the majority of these JSCs remain under state control.26

136. Oversight and monitoring of public enterprises is fragmented. The State Property Committee (SPC) is responsible for (1) the implementation of the privatization strategy of the Government; (2) governance and public enterprises and the management of

26 Under International Financial Reporting Standards effective state control would apply in any case where the Government owns more than 50% of shares; this percentage can be significantly less if the state exercises significant control over the appointment of key management staff or determines the finance and operating policies of the entity.
state property in company’s where state ownership is less than 100 percent. The SPC’s role in governance includes the regulation of production and prices of outputs in a number of economic sectors, establishing the required authorized capital for Joint Stock Companies, and establishing limits of outside ownership in the joint stock entities. Oversight of public enterprises (i.e. 100 percent owned by the state) is the role of the responsible ministry and the COM.

137. **State representation on the Supervisory Board varies according to the percentage ownership of the capital of the entity.** In those cases where the State ownership exceeds 50 percent, the Government appoints the Chairman of the Board. Where the state holds less than 50 percent, a state trustee is appointed from one of a number of professional management companies that provide trustees on a fee for service basis. The Trustee submits a report annually to the SPC describing the activities of the trustee for the period. It does not contain the detailed financial statements, but does provide some financial information on revenues, expenses less salaries, accounts payable and accounts receivable. There is no balance sheet report. The MOF monitors the dividend policy (and revenues into the budget) through the Government’s board trustee.

**Governance of Public Enterprises**

138. Due to ill-defined lines of authority, there is little external and internal discipline on corporate performance, and little effective separation between government and business. There are two broad categories of factors that determine the performance of the modern corporation: the internal incentive arrangements between owners and managers, and the external factors that discipline and monitor the behavior of managers and ultimately the firm’s performance. Under the current corporate framework in Uzbekistan, there is a lack of clarity on the role of directors, relative to shareholders and managers. Conflicts of interest arise as many shareholders and directors of JSCs are also public sector officials who have policy and regulatory responsibilities (See Case Studies for two of the largest public enterprises below).

139. The government could benefit from a single ministry being given responsibility for the financial monitoring of public entity or enterprise operations. This ministry would be responsible for, among other things, developing specific dividend and investment policies to maximize the benefits to the state, engaging external auditors, participating actively on behalf of the central government in the supervisory Boards of public entities or enterprises and preparing the required consolidated financial reports, and including them in notes to the government’s financial statements.

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27 This issue is discussed in detail in Harry G. Broadman, *Competition, Corporate Governance and Regulation in Central Asia: Uzbekistan’s Structural Reform Challenges*, World Bank, May 2000
Case Study – Governance and Financial Management in Major Public Enterprises

Uzbekenergo was created by Presidential Decree in 2001 from the former sector ministry for the generation and distribution of electrical energy. Although 100 percent state-owned, it was established as a Joint Stock Company (JSC) because a number of entities it controls are JSCs. Its revenues come from electricity generation and distribution to regional electricity companies in Uzbekistan. It does not receive subsidies from the State.

Management structure, corporate governance and staffing. The main governing body is the Company’s Council chaired by a deputy prime minister, and including heads of eleven ministries, agencies and two major public enterprise clients (Uzneftgaz, Uzimprom). There is also a Supervisory Council whose primary focus is on strategic development and monitoring economic performance. Its capital investment program is reviewed and approved by the government (Ministry of Economy and Agency for Foreign & External Economic Relations). The organizational structure and staffing levels were established by COM Resolution; however management can make changes within the overall limits of the established staff units. The Management Board comprises of seven members; the Chairman and six deputies, recommended by the Council and approved by the COM.

Accounting, reporting and internal control structures. Internal control is provided by the management structure which ensures compliance with company’s procedures. There is no internal audit function, although a unit similar to CRU performs the control function. Accounting is conducted according to the National Accounting Standards (NAS) and consolidated accounts in accordance with IFRS. Uzbekenergo prepares annual audited financial statements, but there is no requirement that they be tabled in Parliament or published. The financial statements are prepared in accordance with NAS and summary financial statements are presented to shareholders. Copies are sent to the MOF, the State Statistics Committee and the responsible sector ministry. All public enterprises prepare monthly tax reports to the State Tax Commission (STC) and other revenue agents.

Audit arrangements. The Supervisory Board appoints the external auditors. Two audit firms currently audit the company. An international firm conducts an audit of the consolidated entity using international auditing standards and a local audit firm performs audits in accordance with National Accounting Standards for tax purposes as required by law. The CFAA mission was unable to obtain copies of the audit reports. The company undergoes inspection every two years by the STC, as well as regular inspections by the Oil, Gas and Energy Supervision Agency and the MOF Control & Revision Unit.

Uzkomunhizmat (communal utility) was created as a part of the communal utility sector reforms that began in 1993. These reforms began by the privatization of apartment blocks by the Ministry of Housing and Utilities. In 1995, that ministry was transformed into the Ministry of Communal Utilities. Subsequently, a Presidential Decree converted the Ministry of Communal Utilities into Uzkomunhizmat Public Enterprise. It both regulates and manages the gas supply and inter-regional water distribution system. It also finances three research institutes. Because the government has a single-price policy for the provision of gas and water, it manages inter-regional cross-subsidies. The state subsidies the company’s services to permit it to break even on an annual basis.

Management structure, corporate governance and staffing. Uzkomunhizmat is a public holding agency that is 100 percent owned by the state. It reports to the COM through its Supervisory Board which is chaired by a deputy prime minister. There is 25,000 staff distributed throughout Uzbekistan that provides and maintain its gas, water and new capital investment operations. There is a Collegium (Board) approved by the COM, consisting of five members – including the General Director, his deputies and other managerial staff.

Accounting, reporting and internal control structures. Accounting is conducted according to NAS. No audit is required of the Agency’s financial statements. Consolidated financial statements on the activities of the Agency are submitted to the MoF, MoE, among other interested agencies. The Agency has the right to receive and review financial statements from subsidiary companies under it. The wholesale and retail gas tariffs charged by the Agency are set by MOF and approved in the annual budget by the Oliy Majlis. The Agency is subject to the usual inspection regime by the STC, the SCC and other revenue agents. There is no internal audit function, but there is a control inspectorate responsible for bill collection and identification of unauthorized consumers in the gas pipeline network. There are also regional inspectorates created within the regional gas supply companies to carry out the aforementioned tasks. The financial statements are not required to be published, nor are they tabled in Parliament. Copies are sent to the MOF, the State Committee of the Republic of Uzbekistan on Statistics and the MOE.

140. Supervisory Boards should be more independent for public enterprises. These could consist of representatives from major clients, public interest groups and MOF. Board members would have greater accountability for the conduct of the entity’s operations. Budgets and financial statements should be reviewed and approved by the Supervisory Board.

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28 The ISA-based audits are conducted because they are required by IFIs that have financed development activities of the company.
on a regular basis, and the Board should review the auditor’s report on the final statements for the year at the same time as the financial statements

141. **Financial information relating to public enterprises is incomplete and of questionable reliability.** There is no consolidated database on the financial performance of public enterprises. Financial statements are not published or systematically analyzed in Government. As a result there is a lack of information on the magnitude or the extent of their operations and their financial performance. The financial risk posed by public enterprises is therefore not fully known by Government as it does not have timely and accurate financial information on the results of public enterprises’ operations (revenues and expenditures) or on its financial condition (assets and liabilities, contingencies).

142. **Most public enterprises follow the national accounting standards (NAS) and are required to have audits but these do not comply with international standards.** Although NASs are said to be based on International Financial Reporting Standards (IFRS), according to practitioners there are significant differences, for example in the areas of fixed asset valuation and disclosure requirements that undermine transparency of financial reporting. Public enterprises are required to have annual audits of their financial statements. However, these audits are usually conducted primarily for tax purposes and do not comply with international standards.

**Main recommendations**

**Medium term (one to three years)**

143. **Reform of the regulatory framework.** Reforms should be introduced to separate policy and regulatory activities where conflicts of interests arise, and privatize commercial operations so they do not have access to state powers. A legal framework should be created for the management and operations of state owned enterprises, with clear provisions for financial accountability and governance and well established governance structures.

144. **There should be requirement to use International Financial Reporting Standards** for accounting and reporting of the results of the enterprise’s activities in their financial statements. Adoption of International Financial Reporting Standards could be on a phased approach, based on the size and nature of the enterprises.

145. **The Government should encourage the use of independent external auditors to conduct the annual audit of IFRS financial statements of the enterprise, using International Standards of Auditing (ISA).** The Government could conduct select two public enterprises for pilot audits of their 2004 financial statements by an external, private sector international auditing firms using ISA. The audited financial statements should be published.

**Long term (over three years)**

146. **Increase transparency of financial information.** Priority should be given for annual audited financial statements of public enterprises and joint stock companies to be available to the COM, other shareholders and to the Oliy Majlis. These audited financial

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29 The Government should adopt a full translation of International Financial Reporting Standards which could be applied to public interest enterprises; which would include the major public enterprises.
statements should be submitted to the responsible government minister, who would then table them in Parliament within a specified period of time.

147. **Establishment of sector ministries to conduct policy.** The Government should consider devoting to sector ministries in infrastructure sectors, such as energy, the responsibility of defining that set policy and providing advice to the COM on the regulatory framework within those sectors. The Government could investigate ways of strengthening the governance arrangements for government owned agencies to increase the level of transparency and accountability of their operations so that policies are implemented in the way envisaged by the COM.
IX. FINANCIAL MANAGEMENT ARRANGEMENTS IN BANK-FUNDED PROJECTS

Introduction

148. This section reviews the financial management arrangements, in respect of World Bank (the Bank) requirements for IBRD/IDA-financed projects. The present portfolio specifically, it:

(a) assesses the general quality of the financial management arrangements for the Bank-financed portfolio;

(b) highlights the key issues which affect the overall quality of financial management in the Bank portfolio; and

(c) recommends measures to improve financial management arrangements in future Bank operations.

149. The Uzbekistan Bank portfolio currently consists of ten operations (eight IBRD Loans and two IDA Credits). One loan, closed on December 31, 2003, is being extended retroactively, while one loan due to close in June 2004, was extended for a limited period. Subject to the outcome of on-going discussions between the Bank and the Government two new operations may enter the portfolio in FY05. There are also two project preparation activities financed by one PPF Advance and two PHRD Grants.

Financial Management Arrangements

Institutional arrangements

150. All World Bank-financed projects in Uzbekistan have been managed by stand alone project implementing units (PIUs). This mitigates against the risks associated with weaknesses in government systems, but does little to develop long term public sector financial management capacity in government ministries and agencies.

151. Availability of skilled staff remains a challenge. The core fiduciary staff in each PIU includes an accountant and a procurement officer. Recruiting skilled accounting professionals, for projects is difficult; PIUs often hire staff with an economics or bookkeeping background that then undergo training in project financial management. There are a small number of experienced project accountants that tend to rotate amongst the PIUs. In addition PIU staff earns considerably more than government employees. These disparities create resentment with counterparts in the line ministries.

152. PIUs install project financial management systems which are not integrated into the government accounting, reporting and audit systems. They maintain separate audit book-keeping systems and project financial statements are audited annually by private audit firms. These are subject to periodic reviews by World Bank staff to determine their eligibility to audit Bank-financed projects.
Uzbekistan CF

153. **Financial management arrangements for new projects are assessed to meet Bank’s own fiduciary requirements.** The practice is to have acceptable financial management arrangements (i.e. project accounting, financial reporting, internal control, and auditing and financial management staff) early in the project cycle (prior to presenting to the project to the Bank’s Board). This avoids disbursement delays during project implementation. These Bank requirements have generally been met in Uzbekistan.

*Financial Management Supervision*

154. Bank staff conducts risk-based financial management supervision to ensure that financial management arrangements remain effective throughout project implementation. This supervision takes place once or twice a year depending on the assessed level of fiduciary risk.

155. Project financial management systems have generally been satisfactory however some weaknesses have been noted in budgeting, financial reporting and internal control in the Uzbekistan portfolio.

156. *Only a few qualified project audit reports – timeliness remains an issue:* A desk review of the audit reports for FY 2002 indicates that the most projects received an unqualified audit opinion. Only two of the audit reports contained qualified audit opinion. However, compliance with audit covenants was low. Out of eleven projects with audit reports due by June 30, 2003, only six had submitted their audit reports on time. One project had its audit requirement waived due to delays in implementation, while four projects (about 36 percent of the portfolio) had overdue audits, including one audit report that did not meet Bank requirements.

157. The following issues have been identified from bank supervision and audit reports received:

158. *Budgeting:* is usually limited to procurement plans and counterpart funds; it is not consolidated to show the overall position of the project. Budget figures used for quarterly Project Management Reports (PMRs) have been, lifted from the Project Appraisal Documents (PAD) with little reference to the realities of project implementation.

159. *Internal control:* weak organizational structures result in inadequate segregation of responsibilities for executing accounting transactions and reporting on project activities. This has given rise to cases of inaccuracies, errors and incomplete records. None of the PIUs have an internal audit function. Weaknesses in the internal control systems are not detected on a timely basis and often only highlighted in the auditor’s annual management letter. Visits to PIUs by the MOF Control and Revision Unit are generally for inspection purposes to establish non-compliance with tax and other government regulations, not for internal control audits.

160. *Non-compliance with Bank requirements:* On occasion Bank funds have been commingled with other funds and not separately maintained as required. There have also been instances of inadequate accounting for counterpart resources. Due to a lack of counterpart funds, the Bank funds have been often used to pre-finance ineligible expenditures that should have been paid out of counterpart funds.
161. **External Audit**: Uzbekistan is still to develop an independent Supreme Audit Institution which the Bank could rely on for auditing Bank-funds. Currently external audits of Bank-financed projects are performed by independent private sector auditors who are selected in accordance with procurement guidelines and terms of reference approved by the Bank.

162. **Most local firms lack either the technical capacity or the requisite experience to carry out audits of Bank-financed projects.** The Bank carries out periodic on-site assessments of audit firms to determine their eligibility to audit Bank-financed projects.\(^\text{30}\) Other than two of the international audit firms, only one local firm was considered conditionally eligible to carry out project audits.\(^\text{31}\) The majority of Bank-financed projects are audited by international audit firms based in Almaty, Kazakhstan or Tashkent.

**Towards Mainstreaming Project Financial Management**

163. Stand-alone project implementation units have been a necessary short-term, risk-mitigating strategy. Generally fiduciary arrangements for Bank projects function well in Uzbekistan. However, establishing fiduciary safeguards and financial management arrangements outside the national institutions of accountability does nothing to contribute to the development of sustainable financial management capacities in public institutions.

164. The Government’s current efforts in public finance reforms will strengthen public sector financial management arrangements. Work discussed elsewhere in this Report should strengthen accounting and reporting, increase transparency and accountability, create a modern treasury function and institutions of control, audit and supervision. As the government demonstrates progress in addressing its internal control weaknesses the Bank could envisage placing gradual reliance on elements of the Government’s financial management systems, reviewed on a case-by-case basis.

165. Moving towards reliance on national institutions and public financial management systems will require a phased approach based on demonstrable progress towards strengthening these institutions and systems. In the medium term the Government should work towards integrating the PIP and external financing into the budgetary process.\(^\text{32}\) The Ministry of Economy should be responsible for developing a methodology for project appraisal and quality control of proposed projects, which would include financial management arrangements.

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\(^\text{30}\) The last review for Uzbekistan was carried out in May 2003.

\(^\text{31}\) Conditional eligibility means the audit firm does not meet all the requirements for full eligibility; and may only participate in tenders for audit of Bank-financed projects in their countries of domicile.

\(^\text{32}\) This is discussed in more detail in the PER.
## ANNEX I: DEVELOPMENT ACTION MATRIX

<table>
<thead>
<tr>
<th>No.</th>
<th>Recommendation</th>
<th>Policy changes</th>
<th>Institutional Changes</th>
<th>Human Resource/capacity Requirements</th>
<th>Responsible Party</th>
<th>Priority Short/Medium/Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Adopt fully the outline budget process developed for the 2005 budget.</td>
<td>Enact revised budget classification.</td>
<td>Greater integration of MOF into PIP formulation.</td>
<td>Ongoing support from in-country advisors.</td>
<td>MOE, MOF, COM</td>
<td>Short term</td>
</tr>
<tr>
<td>2</td>
<td>The budget, together with documentation on its assumptions and main lines of policy should be published.</td>
<td>Publication of Detailed Budget Documentation</td>
<td>N/A</td>
<td>Ongoing support from in-country advisors.</td>
<td>MOF, COM</td>
<td>Short term</td>
</tr>
<tr>
<td>3</td>
<td>The Budget System Law should be amended to require the enactment of the budget by Parliament and to define appropriations as an authority to spend that is separate from the release of cash.</td>
<td>Revision of Budget Systems Law</td>
<td>Closer involvement of Parliament in budget oversight.</td>
<td>Ongoing support from in-country advisors.</td>
<td>MOF, COM, Parliament.</td>
<td>Medium term</td>
</tr>
<tr>
<td>4</td>
<td>Multi-year PIP process should be reinstated and coordinated by MOF.</td>
<td>N/A</td>
<td>Choice of projects coordinated by MOF.</td>
<td>N/A</td>
<td>MOE, MOF</td>
<td>Medium term</td>
</tr>
<tr>
<td>5</td>
<td>Transparent operational rules and procedures should be developed for the Treasury control of budget execution.</td>
<td>New policies and procedures incorporated into new Treasury Law</td>
<td>Part of on-going treasury reforms.</td>
<td>Ongoing support from in-country advisors.</td>
<td>MOF</td>
<td>Medium term</td>
</tr>
<tr>
<td>6</td>
<td>No new extra-budgetary funds should be created; existing funds incorporated into the Budget where possible.</td>
<td>Decision of Government.</td>
<td>Smaller funds reviewed and, where possible re-integrated in the Budget.</td>
<td>N/A</td>
<td>MOF, COM</td>
<td>Short term</td>
</tr>
<tr>
<td>No.</td>
<td>Recommendation</td>
<td>Policy changes</td>
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<td>7</td>
<td>Extra-budgetary funds should be subject to the same rules as budget entities.</td>
<td>Guidelines for financial management arrangements for EBFs.</td>
<td>Changes to governance arrangements for major EBFs.</td>
<td>Build into on-going work on Treasury Reforms.</td>
<td>Major EBFs, MOF, COM</td>
<td>Medium term</td>
</tr>
<tr>
<td>8</td>
<td>Extra-budgetary funds should be limited to the payments for paid services and not allow budget surpluses.</td>
<td>Policy change to Decree 414.</td>
<td>N/A</td>
<td>N/A</td>
<td>MOF</td>
<td>medium term</td>
</tr>
<tr>
<td>9</td>
<td>Extra-budgetary funds should be included in the treasury system for the purposes of managing cash.</td>
<td>Built into proposals for on-going treasury reforms</td>
<td>N/A</td>
<td>N/A</td>
<td>MOF</td>
<td>Medium term</td>
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**PUBLIC SECTOR ACCOUNTING AND EXTERNAL FINANCIAL REPORTING**

<table>
<thead>
<tr>
<th>No.</th>
<th>Recommendation</th>
<th>Policy changes</th>
<th>Human Resource/capacity Requirements</th>
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<th>Priority Short/Medium/Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Treasury GFMIS User Requirement Document (URD) should confirm commitment to accounting reform process.</td>
<td>Built into URD for Treasury GFMIS.</td>
<td>N/A</td>
<td>N/A</td>
<td>MOF</td>
</tr>
<tr>
<td>11</td>
<td>Train users and providers of financial information on the benefits of public sector accounting and financial reporting.</td>
<td>N/A</td>
<td>N/A</td>
<td>Training on all aspects of public sector accounting and financial reporting.</td>
<td>MOF</td>
</tr>
<tr>
<td>12</td>
<td>Continue the phased development of accounting and reporting standards that conform to international standards.</td>
<td>Legislative changes to budget, accounting laws.</td>
<td>N/A</td>
<td>Technical accounting skills from MOF and private sector</td>
<td>MOF, Accounting profession.</td>
</tr>
<tr>
<td>No.</td>
<td>Recommendation</td>
<td>Policy changes</td>
<td>Institutional Changes</td>
<td>Human Resource/capacity Requirements</td>
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<tr>
<td>13</td>
<td>The annual budget execution report should be subject to audit once the cash accounting standard is implemented.</td>
<td>Amendment to Budget System Law</td>
<td>Chamber of Accounts (COA) provides opinion on annual execution report.</td>
<td>Development of technical skills in MOF and COA.</td>
<td>MOF, COM, COA.</td>
</tr>
<tr>
<td>14</td>
<td>Consider the development of full-accruals accounting based (i) on evaluation of the experience to date in Uzbekistan and (ii) experience of accruals accounting in other economies in transition.</td>
<td>Policy decision on successful completion of 13.</td>
<td>N/A</td>
<td>N/A</td>
<td>MOF, COM.</td>
</tr>
</tbody>
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| REVENUE MANAGEMENT |

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<tr>
<th>No.</th>
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<tbody>
<tr>
<td>15</td>
<td>Implement the proposed amendment to the Tax Code which would restrict access of the State Tax Committee to the banking information of taxpayers.</td>
<td>Amendment to Tax Code</td>
<td>N/A</td>
<td>N/A</td>
<td>COM</td>
<td>Short term</td>
</tr>
<tr>
<td>16</td>
<td>Simplify the number of taxes and reduce the number of exemptions.</td>
<td>Reform of the Tax Code</td>
<td>N/A</td>
<td>N/A</td>
<td>COM</td>
<td>Medium term</td>
</tr>
<tr>
<td>17</td>
<td>Launch capacity building program for enforcement agencies that includes:-</td>
<td>N/A</td>
<td>N/A</td>
<td>Development program for revenue audit and collection agencies.</td>
<td>STC, SCC</td>
<td>Medium term</td>
</tr>
<tr>
<td></td>
<td>• Development of a risk-based model to manage revenue enforcement agencies;</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Identification of IT requirements for auditing based on risk model.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No.</td>
<td>Recommendation</td>
<td>Policy changes</td>
<td>Institutional Changes</td>
<td>Human Resource/capacity Requirements</td>
<td>Responsible Party</td>
<td>Priority Short/Medium/Long Term</td>
</tr>
<tr>
<td>-----</td>
<td>----------------</td>
<td>----------------</td>
<td>----------------------</td>
<td>-------------------------------------</td>
<td>------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>18</td>
<td>Implement the recommendations of previous studies that an internal audit team be created within the new Treasury directorate.</td>
<td>N/A</td>
<td>Creation of Treasury Internal Audit Department.</td>
<td>N/A</td>
<td>MOF</td>
<td>Short term</td>
</tr>
<tr>
<td>19</td>
<td>Develop a long term human resource plan to support the establishment of the Treasury Internal Audit Department (IAD) and CRU within the MOF.</td>
<td>N/A</td>
<td>N/A</td>
<td>Support for development of human resources plan.</td>
<td>MOF</td>
<td>Medium term</td>
</tr>
<tr>
<td>20</td>
<td>Set minimum requirements for the competence and skill requirements of internal auditors within Government.</td>
<td>N/A</td>
<td>Set skills and competency requirements for internal auditors.</td>
<td>Major cultural change required over several years.</td>
<td>MOF</td>
<td>Medium term</td>
</tr>
<tr>
<td>21</td>
<td>Solicit donor support for professional internal audit development programs and training to allow CRU and Treasury and other ministries’ staff to become familiar with international aspects of public sector accounting, internal control and auditing.</td>
<td>N/A</td>
<td>N/A</td>
<td>Training in internal audit/internal controls (could be linked to 24).</td>
<td>MOF, donor community.</td>
<td>Medium term</td>
</tr>
<tr>
<td>22</td>
<td>Include specific new or amended legislation to assign authority and responsibility to the Minister of Finance for the establishment of an effective internal control and audit framework in the Government.</td>
<td>Amendment to existing legislative and institutional arrangements for budgetary control</td>
<td>Clarify the role of MOF and spending agencies with regard to internal control and internal audit.</td>
<td>N/A</td>
<td>MOF, donor community.</td>
<td>Long term</td>
</tr>
</tbody>
</table>
## EXTERNAL AUDIT

<table>
<thead>
<tr>
<th>No.</th>
<th>Recommendation</th>
<th>Policy changes</th>
<th>Institutional Changes</th>
<th>Human Resource/ capacity Requirements</th>
<th>Responsible Party</th>
<th>Priority Short/Medium/Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Implement four point development outlined in report.</td>
<td>New policy for COA independence and for wider dissemination of reports to be reflected in law.</td>
<td>New role of COA to support constitutional reforms.</td>
<td>Training and support in the development and implementation of strategy.</td>
<td>COA, COM</td>
<td>Short term</td>
</tr>
<tr>
<td>24</td>
<td>Develop skills in financial attestation audits.</td>
<td>N/A</td>
<td>N/A</td>
<td>Training and capacity building from SAI.</td>
<td>COA</td>
<td>Medium term</td>
</tr>
<tr>
<td>25</td>
<td>Define and build reporting lines to Parliament.</td>
<td>N/A</td>
<td>N/A</td>
<td>Define reporting lines between COA, COM and Parliament (lower house and Senate).</td>
<td>COA, COM, Parliament</td>
<td>Medium term</td>
</tr>
</tbody>
</table>

## PUBLIC ENTERPRISES

<table>
<thead>
<tr>
<th>No.</th>
<th>Recommendation</th>
<th>Policy changes</th>
<th>Institutional Changes</th>
<th>Human Resource/ capacity Requirements</th>
<th>Responsible Party</th>
<th>Priority Short/Medium/Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>26</td>
<td>Introduce reforms to separate policy and regulatory activities where conflicts of interests arise.</td>
<td>Review of existing governance arrangements to identify potential conflicts</td>
<td>N/A</td>
<td>N/A</td>
<td>COM</td>
<td>Medium term</td>
</tr>
<tr>
<td>27</td>
<td>Require the use of International Financial Reporting Standards for all accounting and reporting of the results of public enterprises’ activities in their financial statements.</td>
<td>N/A</td>
<td>N/A</td>
<td>Training in IFRS</td>
<td>State Property Committee (SPC), COM</td>
<td>Medium term</td>
</tr>
<tr>
<td>No.</td>
<td>Recommendation</td>
<td>Policy changes</td>
<td>Institutional Changes</td>
<td>Human Resource/ capacity Requirements</td>
<td>Responsible Party</td>
<td>Priority Short/Medium/Long Term</td>
</tr>
<tr>
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<td>----------------------------------</td>
</tr>
<tr>
<td>28</td>
<td>The Government should encourage the use of independent external auditors to conduct the annual audit of IFRS financial statements of the enterprise, using International Standards of Auditing (ISA). Two public enterprises should be selected for pilot audits of their 2004 financial statements according to international standards. The results of these audits should be published.</td>
<td>N/A</td>
<td>N/A</td>
<td>Pilot audits under ISA</td>
<td>SPC, COM</td>
<td>Long term</td>
</tr>
<tr>
<td>29</td>
<td>Increase transparency of financial information on all budget entities operating outside the budget, including public enterprises and joint stock companies. These audited financial statements should be submitted to the responsible government minister, who would table them in Parliament within a specified time.</td>
<td>Annual audited financial statements of public enterprises and joint stock companies to be available to the COM, other shareholders and to Parliament.</td>
<td>N/A</td>
<td>N/A</td>
<td>COM</td>
<td>Long term</td>
</tr>
<tr>
<td>30</td>
<td>Establish sector ministries in infrastructure sectors to set policy, advise the government on the regulatory framework and provide strengthened oversight of public enterprises and joint stock companies falling in their portfolio.</td>
<td>Changes based on analysis in No.26</td>
<td>Sector ministries to be identified and functions detailed.</td>
<td>N/A</td>
<td>COM</td>
<td>Long term</td>
</tr>
</tbody>
</table>
ANNEX II - INTERNATIONAL STANDARDS AND CODES

For the purpose of conducting quality CFAAs in all of the Bank’s borrower countries, guidelines and questionnaires have been developed to assist the Bank’s staff in the process of assessing the financial accountability arrangements. The structure of the CFAA follows from these guidelines. Since the administrations of the borrower countries are often looking for benchmarks against which their systems can be measured, this report contains clear references to those internationally accepted standards and codes that employed to develop the CFAA guidelines. In the case of many poor/low capacity countries these standards and codes should be seen as long term goals rather than benchmarks which can be used in the assessment of current systems.

One way of facilitating financial accountability is to promote the application of standards and codes for the practice of the most essential financial management tasks, such as budgeting, accounting, internal control, internal audit and external audit. The internationally accepted standards and codes used in the CFAA report includes those promoted by the Council of Europe, World Bank, IMF, the Organization of Economic Cooperation and Development (OECD), the Committee of the Sponsoring Organizations of the Treadway Commission (COSO), the International Accounting Standards Board (IASB), the International Federation of Accountants (IFAC), the Institute of Internal Auditors (IIA), and the International Organization of Supreme Audit Institutions (INTOSAI). An overview of the standards and codes referred to in this CFAA is presented in table 1.

<table>
<thead>
<tr>
<th>Organization</th>
<th>Standards &amp; Codes</th>
</tr>
</thead>
<tbody>
<tr>
<td>COSO</td>
<td>• Framework for Internal Control</td>
</tr>
<tr>
<td>IASB</td>
<td>• International Accounting Standards (IAS)</td>
</tr>
<tr>
<td></td>
<td>• International Financial Reporting Standards (IFRS)</td>
</tr>
<tr>
<td>IFAC</td>
<td>• International Public Sector Accounting Standards (IPSAS)</td>
</tr>
<tr>
<td></td>
<td>• International Standards on Auditing (ISA)</td>
</tr>
<tr>
<td>IIA</td>
<td>• Standards for the Professional Practice of Internal Auditing (SPPIA)</td>
</tr>
<tr>
<td>IMF</td>
<td>• Code of Good Practices on Fiscal Transparency</td>
</tr>
<tr>
<td></td>
<td>• Government Financial Statistics (GFS 2001)</td>
</tr>
<tr>
<td></td>
<td>• System of National Accounts 93 (SNA 93)</td>
</tr>
<tr>
<td>INTOSAI</td>
<td>• INTOSAI Auditing Standards (INTOSAI AS)</td>
</tr>
<tr>
<td>OECD</td>
<td>• Best Practices for Budget Transparency</td>
</tr>
<tr>
<td></td>
<td>• System of National Accounts 93 (SNA93)</td>
</tr>
<tr>
<td></td>
<td>• OECD Principles of Corporate Governance</td>
</tr>
<tr>
<td>World Bank</td>
<td>• Treasury Reference Model</td>
</tr>
<tr>
<td></td>
<td>• System of National Accounts 93 (SNA 93)</td>
</tr>
</tbody>
</table>
### ANNEX III: LIST OF EXTRA-BUDGETARY FUNDS

<table>
<thead>
<tr>
<th>No</th>
<th>Name</th>
<th>COM Resolution</th>
<th>Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Extra-budgetary Pension Fund</td>
<td>COM Decree No. 459/12/27/96</td>
<td>Accumulation of mandatory social security contributions to finance pensions and social assistance</td>
</tr>
<tr>
<td>2</td>
<td>State Unemployment Fund</td>
<td>Law on employment 05/01/98</td>
<td>Unemployment benefits and active measures in the sphere of employment</td>
</tr>
<tr>
<td>3</td>
<td>Republic’s Road Fund</td>
<td>COM Decree No. 334/06/05/93</td>
<td>Road building, including projecting, building, reconstruction, repair and maintenance</td>
</tr>
<tr>
<td>4</td>
<td>Special State Assets Account</td>
<td>COM Decree No. 481/10/20/97</td>
<td>Accumulation and use of the privatization receipts</td>
</tr>
<tr>
<td>5</td>
<td>Traffic Safety Fund (Ministry of Interior)</td>
<td>COM Decree No. 509-xii/01/13/92</td>
<td>Acquisition of vehicles, computing and video machinery and others building traffic control stations of the State Vehicle Inspection</td>
</tr>
<tr>
<td>6</td>
<td>Special Fund for Pecuniary Aid and Social Protection (Customs)</td>
<td>Presidential Decree UP-1815/07/08/1997 and COM Decree No. 374/07/30/97</td>
<td>Building, reconstruction, repairs, equipments of custom-houses; social spending, including interest-free housing loans for the custom-house officers</td>
</tr>
<tr>
<td>7</td>
<td>Special Fund for Development of the Necessary Equipment of the State Research Chamber</td>
<td>COM Decree No. 82-10/02/18/94</td>
<td>50%-necessary equipment, 45%-social programs, 5%-contingency</td>
</tr>
<tr>
<td>8</td>
<td>Special Fund for Pecuniary Aid and Development of Tax Administration</td>
<td>COM Decree No. 180/05/05/00</td>
<td>Social development of the organs of the tax administration</td>
</tr>
<tr>
<td>9</td>
<td>Trade Unions Council Fund</td>
<td>COM Decree No. 391/08/04/93</td>
<td>Management of social development and social protection of population</td>
</tr>
<tr>
<td>10</td>
<td>Environmental Fund</td>
<td>COM Decree No. 246/05/24/93</td>
<td>Building, reconstruction, repairs of environmental sites, scientific research, sanitary protection and others</td>
</tr>
<tr>
<td>11</td>
<td>Fund for Assistance to Farmers</td>
<td>COM Decree No. 168/04/22/98, Presidential Decree No. 1737/03/18/97</td>
<td>Coordination of the activity of the small private farms, protection of contracts and others</td>
</tr>
<tr>
<td>12</td>
<td>Information and Telecommunication Fund</td>
<td>COM Decree No. 420/08/28/97</td>
<td>Programs and concepts for the development of information systems, technologies and services; regulation and management of radio frequencies, coordination of tariffs. 65%-bonuses, 30%-social development, 5%-contingency</td>
</tr>
<tr>
<td>13</td>
<td>Social Development Fund (Demonopolization and Competition Committee)</td>
<td>MOF Order N071/07/04/96</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Development of the Economic Courts</td>
<td>Presidential Decree No. 564/02/17/93, COM Decree No. 124/03/04/93</td>
<td>Construction, repairs, equipment; social protection and others</td>
</tr>
<tr>
<td>15</td>
<td>Development of Justice and Courts</td>
<td>COM Decree N0523/11/12/92</td>
<td>Construction, repairs, equipment; social protection and others</td>
</tr>
</tbody>
</table>

---

IMF, loc cit, p 64.
# ANNEX IV: OVERVIEW OF GOVERNANCE ARRANGEMENTS – MAJOR EXTRA BUDGETARY FUNDS

<table>
<thead>
<tr>
<th>Item</th>
<th>Road Fund</th>
<th>Pension Fund</th>
<th>Employment Fund</th>
<th>State Property Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal Basis</strong></td>
<td>Law on the Road Fund #720 (2 Feb 1996)</td>
<td>COM Decree # 459 (27 Dec 96); Resolution 498 (23 Dec 2000); Resolution 444 (15 Nov 2000)</td>
<td>Law on Employment 5 Jan 1998</td>
<td>COM Decree # 481 (20 Oct 97)</td>
</tr>
<tr>
<td></td>
<td>COM Decree #334 (5 Jun 93); Resolution 361 (21 Aug 2003)</td>
<td></td>
<td></td>
<td>CoM Resolution #362 (22 Aug 98)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>CoM Resolution #512 (14 Nov 03)</td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td>Percentage charges on all entities and vehicle purchasers³⁴. 5% of revenues go to a Contingency Fund, unexpended funds carryover at year end</td>
<td>- 31.6% of Gross Revenues from Economic entities collected by State Tax Commission as part of the Unified Social Payment, - 2.5% of salary from employees and - 0.7% gross revenues of products (goods and services sold).</td>
<td>- 0.9% of Gross Revenues from Economic entities collected by State Tax Commission as part of the Unified Social Charge;</td>
<td>Privatization receipts from the sale of public enterprises.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>In 2003 55.8 Billion soums were generated.</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td>Construction and reconstruction, equipment for road construction &amp; maintenance. Work performed by Uzavtoyo, a Public Enterprise construction company</td>
<td>Pensions and social benefits and compensatory cash payments for communal services.</td>
<td>Unemployment allowances, training programs and labor market job creation measures targeted for high poverty areas. Monthly surplus distributed to other entities with shortfall.</td>
<td>Revenues are allocated as follows:- 40% - to the State Budget. 30% - Allocated to the appropriate regional administration (Council of Ministers of Karakalpakstan, khakeems’ offices of oblasts, City of Tashkent) for infrastructure development and social projects 5% - stays at SPC for maintenance and administrative expenses, privatization programs, etc. 25% - goes back to the privatized company for technical and production equipment</td>
</tr>
</tbody>
</table>

³⁴ 1.5% gross revenue for economic entities, 2.5% for transport companies; 1% gross income for Wholesale trades, 1.5% for banks and insurance companies; 6% of car and 20% of bus/truck purchase value; transit fees for all vehicles entering or leaving Uzbekistan.
<table>
<thead>
<tr>
<th>Item</th>
<th>Road Fund</th>
<th>Pension Fund</th>
<th>Employment Fund</th>
<th>State Property Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>commercial banks collect and remit RF fees</td>
<td>commercial bank for all Oblasts and another for all Rayons collect remittances from employers</td>
<td>make all payments for Employment Fund</td>
<td></td>
</tr>
<tr>
<td>Organization</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Staff in HQ</td>
<td>45 in Tashkent</td>
<td>8 in Tashkent</td>
<td>3 in Tashkent</td>
<td>10 in Tashkent</td>
</tr>
<tr>
<td>- Staff in Regional Offices</td>
<td>Regional Contracts with <em>Uzavoyol</em> for all construction and maintenance</td>
<td>Approximately 700 in Oblasts and Rayons</td>
<td>Approximately 400 in Oblasts and Rayons</td>
<td>About 30 (=2 in each oblast, RK and Tashkent city)</td>
</tr>
<tr>
<td>Board of Directors</td>
<td>Management Council of 21 person from Ministries, RF and key clients</td>
<td>No, the MLSP has overall accountability for the management of the Fund.</td>
<td>No, the MLSP has overall accountability for the management of the Fund.</td>
<td>Special Supervisory Board plus State Trustees in each Public Enterprise</td>
</tr>
<tr>
<td>Budget Preparation</td>
<td>Based on Fund forecasts of each client sub group</td>
<td>Pension Fund prepares and submits to MLSP for approval</td>
<td>Employment Fund prepares their budget</td>
<td>Prepared by GKI, if no financial dependence on the budget, MOF plays no role.</td>
</tr>
<tr>
<td>Budget Review and Approval</td>
<td>Management Council</td>
<td>STC reviews revenue forecasts; MLSP approves and sends to MOF</td>
<td>STC reviews revenue forecast; MLSP approves and send to MOF</td>
<td>Special Supervisory Board approves budget and sends to MOF</td>
</tr>
<tr>
<td>Budget Execution Monitoring and Control</td>
<td>Execution of the Road Fund budget performed by Road Fund under the Ministry of Finance.</td>
<td>MOF CRU conducts annual inspection.</td>
<td>MOF CRU conducts annual inspection.</td>
<td>MOF CRU conducts annual inspection. Periodic audit by Chamber of Accounts.</td>
</tr>
<tr>
<td>External Board Members</td>
<td>No non-public entity board members</td>
<td>Not applicable</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Approve Budget and Annual Report</td>
<td>Minister of Finance as Chair of the Management Council</td>
<td>Minister of Labor and Social Protection</td>
<td>Minister of Labor and Social Protection</td>
<td>Special Supervisory Board</td>
</tr>
<tr>
<td>External Auditor for Annual Report</td>
<td>No legal requirement for external audit.</td>
<td>Private Sector Auditor</td>
<td>No audit requirement</td>
<td>Chamber of Accounts conducts periodic audits.</td>
</tr>
<tr>
<td>Annual Financial Report Tabled in Parliament</td>
<td>No. Summary of major issues and challenges facing RF.</td>
<td>Yes, by Minister of Finance as part of the Budget Execution Report</td>
<td>Yes, by Minister of Finance as part of the Budget Execution Report</td>
<td>Yes, by Minister of Finance as part of the Budget Execution Report</td>
</tr>
</tbody>
</table>