Republic of Uzbekistan
Country Integrated Fiduciary Assessment

31 March 2011

Operations Services and Quality Department (ECSOQ)
Europe and Central Asia Region

Document of the World Bank
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CURRENCY

Currency Unit = Uzbekistan Soum (UZS)
US$ 1 = 1558 UZS (as of 04/10/2010)

GOVERNMENT FISCAL YEAR
January 1 – December 31

Abbreviations and Acronyms

ADB  Asian Development Bank
ASOSAI Asian Organization of Supreme Audit Institutions
BO  Budget Organization
BSL  Budget Systems Law
CAS  Country Assistance Strategy
CFAA  Country Financial Accountability Assessment
CIFA  Country Integrated Fiduciary Assessment
COM  Cabinet of Ministers
COSO  Committee of Sponsoring Organizations
CPAR  Country Procurement Assessment Report
CPIA  Country Policy and Institutional Assessment
CRU  Control and Revision Unit
EBF  Extra-Budgetary Fund
FRD  Fund for Reconstruction and Development
FSU  Former Soviet Union
GFMIS  Government Financial Management Information System
IAD  Internal Audit Department
IAS  International Accounting Standards
IBRD  International Bank for Reconstruction and Development
IDA  International Development Association
IFAC  International Federation of Accountants
IFRS  International Financial Reporting Standards
IMF  International Monetary Fund
INTOSAI  International Organization of Supreme Audit Institutions
ISA  International Standards on Audit
ISSAI  International Standards of Supreme Audit Institutions
JICA  Japan International Cooperation Agency
MFERIT  Ministry of Foreign Economic Relations, Investment and Trade
MOE  Ministry of the Economy
MOPE  Ministry of Public Education
MOH  Ministry of Health
MOF  Ministry of Finance
OECD  Organization for Economic Cooperation and Development
PEFA  Public Expenditure and Financial Accountability
PFM  Public Financial Management
PFMRP  Public Financial Management Reform Project
PIU  Project Implementation Unit
SME  Small and Medium Enterprises
STF  State Targeted Fund
<table>
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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>TSA</td>
<td>Treasury Single Account</td>
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<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
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<tr>
<td>USD</td>
<td>United States Dollar</td>
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<tr>
<td>UZS</td>
<td>Uzbek Soum</td>
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<tr>
<td>WBG</td>
<td>World Bank Group</td>
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<td>WIS</td>
<td>Welfare Improvement Strategy</td>
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</tbody>
</table>
TABLE OF CONTENTS

PREFACE ........................................................................................................ III

ACKNOWLEDGEMENTS ................................................................................... I

EXECUTIVE SUMMARY ................................................................................... I

  SUMMARY OF KEY RECOMMENDATIONS .................................................. III

I.  COUNTRY CONTEXT ...................................................................................... 1

   ECONOMIC BACKGROUND ........................................................................ 1

      CAS RELATIONSHIP .............................................................................. 2
      PUBLIC FINANCIAL MANAGEMENT BACKGROUND ................................ 3

II. BUDGETING ................................................................................................. 4

   A.  BUDGET PREPARATION ...................................................................... 4
       Recent Progress ...................................................................................... 4
       Analysis ................................................................................................. 6

   B.  BUDGET EXECUTION ........................................................................... 7
       Recent Progress ...................................................................................... 7
       Analysis ................................................................................................. 8
       Recommendations ................................................................................ 11

III. ACCOUNTING, RECORDING AND REPORTING ....................................... 11

   A.  ACCOUNTING ...................................................................................... 11
       Recent Progress ...................................................................................... 11
       Analysis ................................................................................................. 13
       Recommendations ................................................................................ 14

   B.  GOVERNMENT FINANCIAL MANAGEMENT INFORMATION SYSTEM ....... 14
       Recent Progress ...................................................................................... 14
       Analysis ................................................................................................. 15
       Recommendations ................................................................................ 16

   C.  REPORTING .......................................................................................... 17
       Recent Progress ...................................................................................... 17
       Analysis ................................................................................................. 17
       Use of Country Systems ......................................................................... 21
       Recommendations ................................................................................ 21

IV. PUBLIC PROCUREMENT SYSTEMS ............................................................. 22

   Recent Progress ........................................................................................ 23
   Analysis ..................................................................................................... 24
   Recommendations .................................................................................... 28

V.  INTERNAL CONTROL AND AUDIT ............................................................ 28

   A.  INTERNAL CONTROL .......................................................................... 28
       Recent Progress ...................................................................................... 29
       Analysis ................................................................................................. 30
       Recommendations ................................................................................ 33

   B.  INTERNAL AUDIT .................................................................................. 33
       Recent Progress ...................................................................................... 33
       Analysis ................................................................................................. 34

VI. EXTERNAL OVERSIGHT .............................................................................. 37
A. EXTERNAL AUDIT..................................................................................................................37
   Recent Progress ..................................................................................................................38
   Analysis ...............................................................................................................................38
   Recommendations .............................................................................................................42
B. PARLIAMENTARY OVERSIGHT ....................................................................................42
   Recent Progress ..................................................................................................................43
   Analysis ...............................................................................................................................43
   Recommendations .............................................................................................................46

VII. FIDUCIARY RISK IN BANK-FUNDED PROJECTS .........................................................46
A. FINANCIAL MANAGEMENT ARRANGEMENTS .................................................................47
   Project Fiduciary Institutional Arrangements ....................................................................47
   Financial Management Supervision ..................................................................................47
   Towards Mainstreaming Project Financial Management ...................................................49
B. PROCUREMENT ................................................................................................................50
   Project Procurement Risks ...............................................................................................50
   Systemic Project Risks in Procurement .............................................................................51
   Recommendations .............................................................................................................52

VIII. SUMMARY FIDUCIARY RISK ASSESSMENT ..............................................................53

IX. SUMMARY OF CIFA RECOMMENDATIONS .................................................................59

ANNEX I: HIGHLIGHTS OF PFM LEGISLATION .................................................................63

ANNEX II: FIDUCIARY RISK ASSESSMENT .....................................................................66

ANNEX III: IMPLEMENTATION OF PRIOR RECOMMENDATIONS .................................68

LIST OF BOXES

Box A. Fiduciary Risk Components ......................................................................................iv
Box B: Recent PFM-Related Legislation Law on the Budget System (#130/2007) ...............4
Box C: Recent Budget Execution-Related Legislation and Orders ......................................8
Box D: Availability of Information on Resources Received by Service Delivery Units ..........19
Box E: Consequential Internal Audit Policy Decisions .........................................................34
Box F: The Control and Revision Unit of the Ministry of Finance ......................................35
Box G: Main Tasks of the Chamber of Accounts .................................................................39
Box H: Sample List of Extended WB projects ..................................................................51

LIST OF TABLES

Table 1. Selected Macroeconomic Data: 2007-2010 .............................................................2
Table 2: Examples of MFERIT Price Verification Times: ......................................................26
Table 3: Timelines for Consideration of Budget-Related Reports ........................................44
Table 4: World Bank Uzbekistan Project Risk Assessment ...................................................49
Table 5: Duration and delays due to MFERIT contracts expertise in FY2008 .......................50
PREFACE

This is the first comprehensive review of Uzbekistan’s public financial management and procurement systems in seven years. While a number of development partners have examined and made recommendations to improve various components of the Public Financial Management (PFM) and the Procurement systems, a consolidated review of the country’s fiduciary environment had not been completed. This is one of the major contributions of this Country Integrated Fiduciary Assessment (CIFA).

The CIFA has benefits for the government, the Bank and other development partners. It provides an update on all of the various studies conducted by the development partners and the government over the past seven years. It also details the progress made by the government in implementing key reforms in a number of critical PFM areas. These are clearly identified in the individual sections of the report that address the components of the PFM and public procurement system. The report identifies those areas where the government is actively pursuing reforms, and makes specific recommendations for further improvements in a number of components of the system. These data will help inform all parties on the global and specific progress made, initiatives currently underway and areas for further enhancements.

The study has utilized a number of Public Expenditure and Financial Accountability (PEFA) defined indicators during the analysis of its findings. While this is not strictly speaking a PEFA exercise, the use of selected indicators affords the government the opportunity to see its performance against a set of international benchmarks. Because it is not a full PEFA analysis, not all of the indicators and the associated diagnostic discussions were completed for the entire PFM and Procurement systems. Other areas not addressed in this report could be examined within the framework of a full PEFA assessment, the timing of which will be discussed with the Government.

The study did not employ the detailed OECD/DAC criteria for the evaluation of the procurement function. Instead, the single PEFA measure was assessed, for two reasons. First, the information on the procurement function made available to the team was not sufficiently detailed to utilize the OECD/DAC measures. Second, these criteria are better applied to procurement systems at a higher stage of evolution than is the case for the Uzbekistan procurement system.

Objectives and Scope of the CIFA

There are four objectives of this study. Building on the previous PFM and procurement work performed, the CIFA was designed to: (i) provide relevant information to the Bank and the Government on the public sector financial accountability and fiduciary arrangements in Uzbekistan; (ii) identify and document the most significant fiduciary risks\(^1\) in the Government public financial management and procurement systems (PFM); (iii) document the existing program of reforms and capacity building to improve transparency and accountability aspects of the PFM, making proposals for actions that can bring positive change; and (iv) provide a roadmap for the Bank and other development partners to consider the use of country PFM systems in investment projects with adequate fiduciary safeguards. In this regard the CIFA provides an assessment of the feasibility of using components of the government’s PFM and Procurement systems for the financing and control of Bank-financed projects.

\(^1\) The fiduciary risk is the risk of funds not being spent for the purposes for which they have been appropriated.
This CIFA is a joint financial management and procurement exercise. It followed up on the 2003 CPAR and the 2004 CFAA. Its timing is particularly important because of the increased lending program envisaged in the Country Assistance Strategy (CAS) for 2008-2011, and the ongoing PFM reforms being undertaken by the Government with the support of the development partners, as elaborated in the 2007-2018 PFM Strategy. This CIFA assesses the progress made in implementation of the PFM strategy, identifies constraints and provides a set of priority recommendations to assist in meeting the objectives set out in the PFM strategy.

The CIFA assessment enables the Government of Uzbekistan to document progress made in the PFM segment of the CPIA. In 2009 Uzbekistan was a benchmark country for the Country Policy and Institutional Assessments (CPIA). Following the 2009 CPIA, the Government of Uzbekistan and the World Bank have been engaged in high level discussions with the aim of exploring ways of improving the overall CPIA rating. The CIFA report provides a set of recommendations for a country-led program of reforms aimed at improving its CPIA ratings. The CIFA has also provided a suite of recommendation aimed at addressing efficiency constraints related to procurement issues.

The CIFA focuses primarily on the downstream components of the PFM system and the full procurement management and control system. This report examines: the institutional and legal framework for PFM and procurement; budgeting; accounting, recording and reporting; internal financial control and internal audit; external audit and parliamentary oversight; and public procurement operation. For each component, the fiduciary risk is assessed (Box A refers), the potential use of country systems is explored and recommendations are proposed for the consideration of the government. This scope limitation results in a number of PEFA indicators not being addressed in the report. These additional PEFA indicators would be quantified in the assessment of the additional PFM components in the framework of full PEFA assessment.

<table>
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<th>Box A. Fiduciary Risk Components</th>
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<td>- Funds may be diverted from the intended recipients</td>
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<td>- Funds may be misused for inappropriate, unauthorized, unknown, or corrupt purposes</td>
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<td>- Authorized funds may be misallocated even if for legal purposes,</td>
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<td>- Fund utilization may be subject to late, unreliable, or incomplete financial reporting</td>
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<td>- Budget implementation may fail to achieve its objectives</td>
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Source: World Bank
ACKNOWLEDGEMENTS

This report is based on the results of interviews and discussions with officials and staff of the Ministry of Finance, including the Treasury, two line ministries, the Prosecutor’s Department, the Chamber of Accounts and Chairs of the Budget and Economic Reforms Committees of both Houses of Parliament. The analysis of data gathered during the mission included copies of relevant legislation, instructions and reports. Many Government counterparts lent their support to the CIFA Mission and engaged in the dialogue. The team is grateful for their cooperation.

The CIFA team wishes to acknowledge the extensive cooperation and assistance received from government officials and staff in other institutions. They included senior officials from the Ministry of Finance: Mr. R. Gulyamov (First Deputy Minister of Finance), Mr. B. Ashrafkhanov (Deputy Minister of Finance/Head of Treasury), Ms. E. Ostrogojskaya, Mr. M. Olloerov, Mr. D. Ubaydullaev, Mr. S. Usmonov, Mr. M. Agzamov and their respective staffs in the MOF/Treasury. The team also acknowledges the contributions of other senior officials, including Mr. S. Tulyaganov, Mr. O. Sobirov, Mr. U. Daulanov, Mr. J. Niyazbekov, Mr. F. Khabibullaev, Mr. A. Alimov, Mr. B. Khashimov, Mr. U. Sunnatov, Mr. Z. Dusanov, Mr. E. Kolenko, Mr. B. Ziyaev, Mr. S. Aliev, Mr. S. Gulyamov, Mr. A. Tadjibaev, Mr. K. Akmalov, Mr. O. Rustamov, Mr. A. Akhadoev, Mr. Mr. U. Zokirov, Ms. A. Nishonova, Ms. F. Omonova, Mr. H. Akbarov, Mr. Djalilov, Mr. A. Altyev, Mr. E. Alimov, Mr. A. Burkhanov, Mr. R. Buriev, Mr. K. Kamalov, Mr. V. Kilberg, Mr. U. Abruev, Mr. J. Sattarov, Mr. B. Sugirbaev, Mr. F. Rajabov, Mr. N. Zaitov and their staff. Mr. J. Zohrab and Mr. O. Ganiev of the IMF provided invaluable help throughout the mission. Our thanks also go to the UNDP staff members Mr. S. Akbarov and Mr. H. Rustamov in the Tashkent Office, as well as Mr. R. Abdukayumov of the ADB Tashkent office.

This report was prepared by a team led by John Ogallo (ECSO3) and comprising Marius Koen, Galina Alagardova (ECSO3), Yuling Zhou, Fasliddin Rakhimov (ECSO2), Andy Macdonald (PFM Consultant) and Jakhongir Kakharov (Local Consultant), with support from Eskender Trushin (ECSP1), Sevara Abdusamatova, Rumiya Garipova, Oydin Dyusbaeva, Gulnora Kamilova, Elena Klementyeva and Irina Tsoy (ECCUZ). The report benefited from guidance from Loup Brefort (Country Manager), Moustapha Ndiaye (FM Manager, ECA) and Devesh Mishra (RPM, ECA), as well as quality review by Lewis Hawke (ECSO3) and peer reviewers: Ekaterina Vashakmadze (ECSP1), Naushad Khan (RASPS) Olav Christensen (HDNED) and John Zohrab (IMF Fiscal Advisor).
EXECUTIVE SUMMARY

a. The relative isolation of the Uzbekistan economy from the international financial crisis means that its economy has recovered rather unscathed. GDP growth continued in strong positive territory, with a slight decline from 9% in 2007/2008 to 8.1% in 2008/2009. The main impact of the global economic slowdown was on the balance of payments, with a small net increase in overall exports and a 30% reduction in remittances. A significant stimulus program helped stabilize the economy, while interest rates are in the 6 to 8 percent range for the current period.

b. The economic management and governance remain characterized by low transparency, and limited voice and participation of citizens. The restricted dissemination of basic economic and social information, and questions regarding the reliability of some data, remain impediments to strengthening the accountability of the authorities. There is little encouragement of public participation in policy-making debate, and the civil society plays limited constructive role in contributing to the effective monitoring and evaluation of implementation and results of state programs. However, the government has indicated that it is working to enhance information dissemination and increase involvement of civil society in implementation of state programs.

c. The government has been very active in its Treasury-related public financial management reforms. With the assistance of the IMF and other development partners, the Treasury function is now established in law and in fact. A Treasury Single account is now processing the majority of government spending, both budgetary and non-budgetary and all spending and revenue transactions will be covered beginning in 2011. In addition, a GFS 2001-compliant chart of accounts has been implemented for all of the transactions of the government in both budgeting and reporting. This represents a major improvement in the quality and the comprehensiveness of the government’s information processing and analytical capacities.

d. The CIFA report recommendations are fully consistent with the long-term strategic PFM plan adopted within the Ministry of Finance to guide its PFM reforms until 2018. The Strategic Plan includes a strategy for the implementation of accrual-based accounting, adopting more international standards for accounting, the acquisition of a new Government Financial Management Information System and more transparent reporting. This plan, while strong in design, requires the approval of the Cabinet of Ministers to establish formally its scope and mandate, as well as future resourcing. The strategy also needs to be broadened to cover key accountability functions of internal and external audit that would supplement the gains from implementation of the Treasury system. To ensure effectiveness of the reforms there is need for a PFM reform coordination team in government to coordinate the various PFM initiatives supported by development partners. Such coordination would minimize the risk of fragmentation and overstretching of government capacity.

e. Public procurement involves a large component of the government’s budget and is an important key to improved effectiveness of operations and of cost control. Procurement systems tend to be complex, multi-stage processes involving multiple stages of approval by different parties. The processes are not transparent. These characteristics are significant in that

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they establish a fertile ground for fraud and corruption. As such, more significant improvements in the public procurement system are warranted.

f. **While there has been some limited progress on improving the procurement activities of government, more still needs to be done.** The procurement system remains well behind the PFM system in progress towards modernization and to meet international best practices.\(^3\) Areas for improvement include: a public perception that the procurement process is not transparent enough and lacks credibility; private sector suppliers and contractors remain unsatisfied with the rules governing public procurement and have little confidence in the system’s fairness; the legislative framework for procurement is fragmented. In addition there is: no unified public procurement law in line with good international model and practice; there is no single institutional oversight or regulatory authority for public procurement; and no effective complaint handling mechanism.

g. **The development and implementation of new procurement policies and processes may take considerable time to achieve.** Some recommendations may be short term in nature and could be readily developed and implemented by the government. Others may be more long term in nature and require several years to complete. The important decision is for the government to recognize that a problem exists in procurement, and to endorse a series of specific reforms to remedy the problems.

h. **Uzbekistan’s budget proposals and final budget reports are not sufficiently transparent to the wider public.** Nor are the reports of the Chamber of Accounts on the budget documents, and on its annual audit activities, findings and recommendations. Transparency creates trust, promotes more public involvement and commitment and benefits the economic development of the country. Access to economic and financial information and related data remains a big challenge, and additional opportunities for more transparent reporting are, therefore, identified.

i. **Internal audit remains an outstanding effectiveness opportunity for the government.** It has the resources of the Control and Revision Units, from which the seeds of a modern, international standards-based internal audit function may be built. Studies have been conducted and a number of proposals for the implementation of internal audit have been formulated. It is now for the government to make the decision to proceed and to resource and initiate a phased implementation plan for establishment of appropriate institutional and legal framework, using material already developed under the recently closed project financed by the Bank’s IDF grant\(^4\).

j. **The external audit function is at the point of transition to standards-based external auditing that is compliant with INTOSAI standards.** Revisions to its legislative base to provide for greater independence, financial flexibility, the planning and conduct of its audits, the use of audit standards and the reporting of audit findings would provide additional enhancements to its operations. A draft external audit law exists, developed with support from EU-TACIS, and its revision and enactment would provide a solid legal framework for the performance of external audit in the country.

k. **The government financial control systems are now sufficiently robust in certain areas to permit piloting the use of the government’s financial treasury system to manage investment projects.** This has multiple benefits for the Bank and the government, involving

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\(^{3}\) Transparency International assigned Uzbekistan a Corruption Preconception Index of 1.7 in 2009.

\(^{4}\) IDF Grant for Capacity Building in Public Sector Audit Institutions
improved staff capacity to perform financial management control over projects and to extend the
learning from such a pilot to progressively introduce the use of country systems in investments
projects financed by international financial institutions.

I. Staff development and training remain an important management consideration,
particularly when the government is reforming major components of its PFM systems.
Continuous and focused training to develop the staff capacities to maintain and grow these
systems is critical.

Summary of Key Recommendations

m. Seven key recommendations are presented in the summary below. There are many
other recommendations contained in the report that respond to the findings in key components of
the PFM system. While all the recommendations are important the seven areas described below
are critical and should be considered by the government for higher priority attention in its reform
agenda contained in the Ministry of Finance’s Strategic Plan 2007-2018.

(i) The MOF should consider requesting the Cabinet of Ministers, at the appropriate
time, to establish a strong legal, institutional and regulatory framework for the conduct of
its public procurement activities.

n. This is a critically important reform for the government in order to further improve
its control over spending. The government has concentrated on achieving a sound basis for a
treasury system and has made good progress. While there is a Public Procurement System
currently in place, it is weak and requires considerable strengthening. It is now the time to begin
a process for the reform of the public procurement system, bringing it into line with international
standards for public procurement legislation and practice. Over time, this could include new,
international standards-based contracting processes, new documentation, a new entity established
to perform procurement policy development and monitoring and an independent procurement
appeals mechanism.

(ii) The government should make a formal decision on the adoption of International
Public Sector Accounting Standards for accrual accounting and its phased implementation
over several years as described fully in its 2007-2018 Strategic Plan.

o. MOF has advised the team that they follow international standards (unspecified)
that are adjusted to the Uzbekistan environment. In fact, Uzbekistan, like the other former
Soviet Union countries, had for many years followed a form of partial accrual accounting, in
which revenues and payables were accrued. Thus for these countries, re-starting the process of
migration to accrual accounting will not appear particularly novel. The government should make
a formal public decision to adopt fully the International Public Sector Accounting Standards’
accrual-based accounting standards and then proceed with the allocation of sufficient resources
within MOF to implement its already-endorsed plan. A decision at this time on the nature of the
accounting recognition principles to be embedded in the system would be of considerable
assistance to the GFMIS project. The phased implementation of accrual accounting over a
medium term is being pursued by many countries in the region.

(iii) The government should establish an institutional and legal framework for internal
audit, and implement it progressively over the medium term across all significant budget
organizations.
p. **An internal audit migration strategy, with a strong capacity development component, is also required.** The internal audit standards and practices should comply with existing international standards issued by the Institute of Internal Auditors (IIA). A strong and modern internal audit function will strengthen management responsibility and accountability for establishing and maintaining sound internal controls over the government’s assets and financial resources under management control. A starting point would be the development of an internal audit strategy that could be implemented in phases, starting with the Treasury, where an internal control division has been established, followed by a roll out to other line ministries.

(iv) *The government should increase the quantity and the transparency of its financial information that it provides to the public, international community and its development partners.*

q. **The government closely controls the disclosure of all financial and economic information.** Given the government’s progress in implementing key elements of public financial management reforms, the inadequate access to financial and economic information is surprising. The government has much to gain, and little to lose, by being more open and transparent in the provision of its data whose quality is steadily increasing year by year. It would increase the understanding and the support of the international community, the development partners and the general public if they were able to see the demonstrable progress already achieved, and that planned for the future.

(v) *The government should introduce on a pilot basis the use of its Treasury system for the expenditure control of projects financed by international financial institutions, as a move towards greater reliance on country systems for investment projects.*

r. **This is consistent with the intent of the Paris declaration and the Accra Agenda of Action.** There are a number of benefits that arise from the government assuming gradual responsibility for management investment projects: development of staff capacity in project management; increased government involvement, commitment and ownership in projects financed by the World Bank and other development partners; the identification of future areas for enhancement of existing in-country systems; and reduction in the overhead cost of project management and control. This would be in line with the current Government practice of channeling counterpart contributions to investment projects through the Treasury System.

(vi) *The MOF should consider requesting the Cabinet of Ministers, at an appropriate time, to approve the phased implementation of appropriation-based budgeting for all aspects of its budgeting and reporting systems.*

s. **The adoption of the parliamentary appropriations basis of budgeting is one of the most important PFM reform opportunities facing the government today.** The use of specific appropriations for each budget organization, broken down into key components selected by the government, will offer a significant increase in transparency over the more aggregated presentation presently in place. Its adoption will enable further identified improvements in a logical and supportive financial systems environment. It should be accorded the highest priority for funding and for implementation. However, this would need to be accompanied by capacity building for budget preparers, MOF and the appropriate parliamentary committees.

(vii) *The MOF should establish a PFM Coordination team to take charge of reforms in*
a holistic way to avoid fragmentation and overstretching of government capacity.

t. Establishment of an inter-ministerial PFM Coordination team, under the leadership of the Ministry of Finance would consolidate all the reform efforts undertaken by the government and supported by various development partners. At the moment there are a number of activities supported by donors without a common theme. Even the 2002-2018 PFM Strategic Plan does not cover all the key elements of PFM, such as audit; and the strategy itself has not been given a formal seal of approval by way of government resolution. The PFM coordination team would minimize the risk of fragmentation of PFM activities and harness existing government capacity for effective implementation of the reforms.
I. COUNTRY CONTEXT

Economic Background

1. Uzbekistan’s economy emerged from the global slowdown relatively unscathed. This was due “inter alia to the relative isolation of its financial system and its exports of gas and gold, whose prices remained strong. The average price of gas exported to Russia increased from $180/1,000 m3 in 2008 to $200/1,000 m3 in 2009, or by 11 percent. According to government data, GDP growth, having accelerated from 7 percent in 2005 to over 9 percent in 2007-08, declined only slightly to 8.1 percent in 2009, in line with the government’s target. Meanwhile, in 2008, the current account surplus was 12.8 percent of GDP, gross international reserves totaled $9.6 billion (equivalent to almost 12 months of imports), the extra-budgetary Fund for Reconstruction and Development (FRD) accumulated a fiscal surplus equivalent to 10 percent of GDP. The augmented total budget surplus was an estimated 10.2 percent of GDP, and total external debt totaled $4 billion, or just about 14.3 percent of GDP.

2. Against this background the main impact of the global economic slowdown was on the balance of payments. This resulted from lower demand for exports such as automobiles, copper, cotton, and chemicals. For example, automobile exports declined sharply by 62 percent, copper declined by 28 percent, chemicals by 9 percent, and cotton by 5 percent in 2009. On the other hand, gold exports were little affected, and natural gas and foodstuffs exports have increased by 42 and 39 percent respectively, so that total exports grew by 2.1 percent in 2009 and the trade surplus was $2.3 billion. Labor migrants’ remittances also declined by about 30% in 2009.

3. In 2009 the Government implemented a large fiscal stimulus package, equivalent to 4 percent of GDP, designed to offset the economic and social consequences of the slowdown. It included a 40 percent increase in public sector salaries in 2009, a further 30 percent increase in 2010, and a commitment of about $1.7 billion equivalent for employment creation in rural areas (amounting to) 734,500 jobs in 2009 and 950,000 in 2010, increased foodstuffs production, widening of industrial localization program, reduction in some taxes and fees for SMEs, additional public investment in infrastructure, full guarantee of people’s deposits in banks, enterprise financial restructuring, etc. Despite this surge in welfare spending, the budget recorded a small surplus of 0.1 percent of GDP in 2009 and targets a deficit of only 1 percent of GDP in 2010. Moreover, FRD savings increased from $2.7 billion in 2008 to $3.7 billion in 2009.

4. The Government also undertook steps to increase the capital of commercial banks in order to strengthen the long-term resource base for investment. This was specifically in small-scale private enterprise and rural housing as well as to mitigate the consequences of the crisis. The capital adequacy of the banking system in terms of risk-weighted assets remained at about 23 percent, twice the Central Bank’s minimum requirements and thrice those of international standards.

5. While these anti-crisis measures and the authorities’ restrictive policies helped weather the storm, they have also had some perverse effects. These include: (a) a large and persistent spread between the official and market foreign exchange rates, which increased from 6

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5 This economic analysis was provided by the World Bank Country Office, Tashkent, April 2010.
percent in January 2009 to 45 percent in March 2010; and (b) further increase of already high role of the state in the Uzbek economy, and (c) a potential increase in inflation. In addition, the longer-term fiscal impact of increased welfare spending and public sector wages is uncertain. Table 1 summarizes some of the key macro indicators for the period.”

Table 1: Selected Macroeconomic Data: 2007-2010

<table>
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<th>Indicator</th>
<th>2007</th>
<th>2008</th>
<th>2009 est</th>
<th>2010 fct</th>
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<td>NATIONAL ACCOUNTS (% GDP)</td>
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<td></td>
</tr>
<tr>
<td>GDP</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>24.0</td>
<td>21.4</td>
<td>19.5</td>
<td>19.9</td>
</tr>
<tr>
<td>Industry</td>
<td>32.0</td>
<td>30.8</td>
<td>33.2</td>
<td>32.5</td>
</tr>
<tr>
<td>Services</td>
<td>44.0</td>
<td>47.9</td>
<td>47.3</td>
<td>47.6</td>
</tr>
<tr>
<td>Total Consumption</td>
<td>70.5</td>
<td>70.9</td>
<td>69.8</td>
<td>68.6</td>
</tr>
<tr>
<td>MEMORANDUM ACCOUNTS</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Domestic Fixed Investment</td>
<td>19.4</td>
<td>23.0</td>
<td>26.1</td>
<td>26.2</td>
</tr>
<tr>
<td>GDP (US$ millions @ current prices)</td>
<td>22308</td>
<td>27934</td>
<td>32797</td>
<td>34556</td>
</tr>
<tr>
<td>PUBLIC FINANCES (% GDP at MARKET PRICES)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Revenues</td>
<td>31.7</td>
<td>31.6</td>
<td>32.3</td>
<td>33.6</td>
</tr>
<tr>
<td>Current Expenditures</td>
<td>27.1</td>
<td>28.6</td>
<td>32.6</td>
<td>29.9</td>
</tr>
<tr>
<td>Current Account Surplus/Deficit</td>
<td>4.5</td>
<td>2.9</td>
<td>-0.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>4.0</td>
<td>3.5</td>
<td>3.8</td>
<td>3.1</td>
</tr>
<tr>
<td>Foreign Financing</td>
<td>0.3</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Real Interest rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPI (% Change)</td>
<td>6.8</td>
<td>7.4</td>
<td>7.1</td>
<td>8.2</td>
</tr>
<tr>
<td>GDP Deflator (% Change)</td>
<td>24.0</td>
<td>19.9</td>
<td>20.8</td>
<td>21.2</td>
</tr>
</tbody>
</table>

Source: World Bank

CAS Relationship

6. **A Country Assistance Strategy (CAS) for Uzbekistan was approved by the Board in May 2008**, covering the period FY08 – FY11. It proposed non-lending engagement through sector and cross sector work that supports government’s reform efforts and promotes good governance as a way of improving efficiency, effectiveness and quality of service delivery. The CAS supports the government’s challenge of a more transparent and efficient allocation of resources through reforms in public expenditure management. With the goal of sustaining and broadening growth, improving quality of life and increasing competitiveness the CAS aims to improve the fiduciary environment and capacities by promoting good international practice of PFM based upon PEFA type performance measurement indicators. The CAS also seeks to engage the Government in discussing issues that underlie low governance-related Country Policy and Institutional Assessment (CPIA) indicators. The use of selected PEFA indicators in this CIFA affords the government opportunity to see its performance against a set of international PFM benchmarks.

7. **The CAS envisaged a Base Case lending scenario of approximately $100 million per annum over the period.** This represented a total of US$ 373 million, which is mainly for investment projects. There is no provision for budget support operations in the CAS which supports the Government’s own version of the Poverty Reduction Strategy Paper, the Welfare Improvement Paper (WIS). Although Uzbekistan is potentially a blend country, at the time of the
CAS preparation the authorities had not indicated interest in borrowing on IBRD terms. However, during preparation of the CAS Progress Report the Government has expressed a desire to borrow on IBRD terms, and the final year of this CAS may include some lending on IBRD terms. A creditworthiness assessment was triggered by the Government request, and the assessment of the fiduciary environment embedded in this CIFA supplements this assessment.

8. **Within the CAS period the Bank’s lending activity has focused on investment projects.** Current fiduciary safeguards and financial management in the Uzbekistan portfolio is arranged outside the national institutions of accountability using stand-alone project implementation units. The CAS recognized four critical risks that may impact on the core World Bank Group (WBG) program, including: high fiduciary risks because of weak public finance management capacity; inadequate accountability mechanisms; a lack of financial and fiscal transparency; and weaknesses in procurement. To mitigate these fiduciary risks, particularly for new projects, the CAS placed emphasis on improvement of transparency and accountability at the sector and project level, while being cautious on the move to make use of country systems.

**Public Financial Management Background**

9. **Over the last decade the World Bank and other development partners have conducted many diagnostic studies on the country’s PFM and fiduciary environment.** The ADB completed a base line study on Financial Management and Governance Issues in 2000. Other studies included the 2003 World Bank Country Procurement Assessment Report and the 2004 Country Financial Accountability Assessment, as well as a Public Expenditure Review in 2005 and a 2008 Assessment of the Primary Health Care Reform - Transparency, Accountability and Efficiency. The IMF has maintained a continuous involvement in treasury systems, accounting, reporting and legislative reforms over the same period. Other donors have also performed analytical work, in part related to the PFM system. These included the European Union’s support for the development of the external audit function and the Asian Development Bank’s support for the Public Financial Management Reform Project (PFMRP).

10. **MOF is currently implementing a Public Finance Management Reform Project.** It supports restructuring the institutions of budget preparation and execution including finance for equipment and software related to the establishment of the Treasury system. This project, as originally prepared with substantial WBG support, had two main development objectives: to improve transparency and accountability of public finances; and to strengthen institutional capacity to use public resources more effectively, efficiently and transparently, in line with Government priorities.

11. **Reforms across the PFM system have proceeded slowly, but progressively.** The government has made good progress in implementing a GFS-compliant classification and coding system, creation of a dedicated Treasury unit within the Ministry of Finance, the establishment of a treasury single account (TSA), consolidation of all extra-budgetary funds and those extra-budgetary special accounts of budget entities into the TSA, and the implementation of interim financial management information systems in advance of the implementation of a full Government Financial Management Information System.\(^6\)

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\(^6\) The exception is the Basic Education in which fiduciary elements are mainstreamed within the Ministry of Public Education, with support from local consultants.

\(^7\) The bid process for the GFMIS is presently underway (May 2010).
II. BUDGETING

A. Budget Preparation

Recent Progress

12. The government has been amending its existing legal framework to reflect the implementation of its reform agenda. The legislation and related regulations establish the foundation for a sound framework for financial management. This is a combination of the laws passed in Parliament, Presidential decrees and resolutions, Cabinet of Minister resolutions and ministerial orders. In the case of Public Financial Management, the Minister of Finance issues the ministerial orders. Box B summarizes the recent legislative changes for PFM enhancement.

13. The 2005 Law on Improving the Budget Classification, which was amended in 2007 and 2009, introduced a new budget classification system that is compliant with the GFS-2001 budget classification system. This system is also being used in budget execution and reporting. The adoption of the new classification distinguishes between the economic, administrative and functional classifications, making a clear distinction between revenues, expenditures and financing transactions, as well as between transfers and exchange transactions.

14. The 2000 Law on the Budget System, amended in 2007 and in 2009, revised the operation of the Uzbekistan budget system. It specified: the organizational and administrative basis for the revised budget system now that the Treasury function had been established; the principles and the structure of the State Budget; the procedures for preparation, review, adoption, and execution of the State Budget; the principles for revenue and expense generation of the State Budget; the relationship between the budgets within the structure of the State Budget; and the accounting, reporting, and control procedures for funds of the State Budget.

15. An especially significant order of the Minister of Finance was promulgated in 2008 to establish the specific budget classification codes and structures. This was for use by all ministries, departments and agencies for their budget preparation, execution and reporting. This common coding structure covers all potential coding of expenditure, revenue and other transaction types in a structure that reflects international standards (GFSM 2001). This has been implemented with the introduction of the Operations Manual on Bookkeeping in Budget Organizations in January 2011. Providing that general government sector data is disclosed using this classification, this will facilitate subsequent interaction with those development partners who are interested in both the macroeconomic and microeconomic data forecasts as part of their global monitoring responsibilities.

16. The government has also made preliminary steps to implement a three-year medium term fiscal framework (MTFF). The first such framework, first prepared in 2005 on a preliminary basis, reflected the government’s Welfare Improvement Strategy and Program. It consisted of a medium term projection of the economy, forecast revenues and expenditure targets.

Box B: Recent PFM-Related Legislation

- Law on the Budget System (#130/2007)
- Minister of Finance Order, On Approval of Revenue, Expenditure (Functional and Economic) and Fund Classification of the State Budget (#80/2008)
- Minister of Finance Order #105/2010 Operations Manual on Accounting in Budget Organization

Source: MOF
for the period, and set ceilings for each sector of government operations, the budget deficit and annual levels of borrowing. However, the 2005 MTFF exercise has not yet been repeated, because of capacity problems in the MOF.

17. **Attention is being given to the gradual development of program-based budgets.** This would replace the present input budgeting approach that continues to be practiced in many countries. The approach has begun in pilot ministries, with the Ministry of Education being an early candidate. The introduction of program budgeting is designed to provide a more direct link between government policies and priorities and the annual budgets of the ministries that will have the responsibility for implementing these policy priorities. However, because of its complexity and demands on the limited capacity of line ministries, there are no concrete plans to develop program budgeting beyond the pilot stage; the target dates for full program budgeting set out in the PFM Reform Strategy 2007-18 are unlikely to be met.

18. **The UNDP has been assisting the Government with the further implementation of its PFM reform program.** Under the Public Financial Management Reform Strategy 2007-2018, approved by the Minister of Finance, a number of budget preparation reforms were identified for action:

- **The elimination of conflicting provisions between** the budget systems law and the Treasury law was accomplished through the 2007 amendments to the BSL.  

- **The authorization for the MOF to promulgate without any further approval from Parliament the** budget classification used for both appropriations and final budget statements has yet to be made. However, Article 11 of the Budget Systems Law is currently being used as the authority; additional amendments requiring the use of internal standards, the application of classification standards and for program and fund classifications are required.

- **The changes to the BSL to reflect fully the provisions of the IMF Code of Good Practices for Fiscal Transparency** for definitions of budget contents and their disclosure requirements have not yet been implemented. The Code applies to the annual budget documents, budget execution reports and associated documents (such as the Medium Term Budget Framework and the annual financial statements) and also specifies the use of international accounting standards employed in their preparation.

- **The publishing of the annual budget and the final budget report.** The Government did publish the budget and the budget execution report for a few years, but then discontinued it in part because of apparent lack of external interest. This report suggests that this initiative should be reactivated with greater use made of multiple media distribution channels (MOF Web site, social media, and newspaper summaries, media interviews) to further stimulate interest and demand.

- **The application of the Code of Good Practices for Fiscal Transparency to the budget preparation procedures.** The changes to the budget systems law to reflect fully the provisions of the Code of Good Practices on Fiscal Transparency concerning budget preparation procedures have also not yet been implemented. All budgets should include: fixed expenditure ceilings, MTBF and annual budget statements of policy, objectives and

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8 The changes to Article 11 of the BSL with respect to budget classification have not yet been made. However, these changes are not major, nor are they a prerequisite for the implementation of a revised classification system.
targets. To date, this has not been formally implemented, however, a limited number of changes have been incorporated into other recent legislation.

- **Definition of a parliamentary appropriation process** that covers the budgets of the entire government and involves parliamentary submission, deliberation and approval stages. It includes Treasury involvement to ensure: the separation between the release of cash and the release of budgetary authority derived from parliamentary appropriation; unused appropriations lapsing at year-end; the definition of appropriation according to the organizational, economic, fund and program (or functional) classifications via an annual budget law; and various potential flexibilities delegated to MOF regarding the management of the ongoing appropriation levels.

19. **The next phase of the UNDP public finance project is expected to focus, inter alia, on the move to a parliamentary appropriation basis of budgeting.** The adoption of this new basis for budgeting is consistent with international best practices and provides for more information to Parliament to promote government agency accountability for performance.

**Analysis**

20. **The government is moving effectively to consolidate its state entity for budget preparation, execution and reporting purposes.** The consolidation within the Treasury’s coverage of the many funds and accounts currently outside the budget has considerably expanded the scope and transparency of the state’s activities. In due course, this should be further enhanced by parliamentary appropriation of these funds and accounts, which would make them funds and accounts within an expanded state budget. This strengthened consolidation will contribute to the authorities’ being able to meet the IMF’s statistical reporting standards and their requirement for improved classification of comprehensive and accurate financial information, historical as well as forecast.

21. **The new classification system for all transaction types will enable a more meaningful disaggregated budget presentation.** For the budget preparation process this change will increase the amount of detail available for MOF, COM and Parliament during their review of the budget proposals. It will also enable a detailed budget – actual comparison at any level of expenditures and revenues, enabling the ministries to better manage their budget preparation forecasting skills for subsequent years’ budgets.

22. **There are many benefits to moving to resuming the parliamentary appropriations basis for budgeting that applied during the USSR era, modernized according to good international practice.** The appropriations would be established at the ministry level to provide an additional degree of disclosure of the government spending plans in its budget and in the budget execution report. As noted by both the World Bank and the IMF the legislation should make clear that appropriations are an *authority to spend* that is separate from *the release of cash*. This distinction has become clearer with the establishment of the Treasury, but its codification in statute would enhance the transparency to the budget proposals for parliamentary oversight and monitoring.

23. **Some questions, which always arise in countries when proposals to increase the involvement of parliament in public finance are made, remain as to whether:**

- Parliament has the necessary expertise to examine the budget on this basis. This is a question of training that the UNDP project is planning to address and is a matter of time and
effort. There is no reason to believe that Uzbekistan members of parliament will not in due course achieve the same level of expertise as their counterparts in other countries;

- Control over public finance will be weakened by the greater involvement of Parliament. International experience over time and across countries is that Parliament is a force for fiscal prudence and efficiency, helping to keep spending ministries and corruption in check and relieving the government and the MOF of some of the burden of resisting spending pressures; and

- The additional effort that the MOF would need to devote to relations with Parliament would not be worthwhile. International experience over time and across countries suggests that it is worth the effort, and that Parliament is an ally of the MOF in maintaining fiscal discipline.

It would appear that Parliament itself is confident on these issues. The reform should be pursued further and the government should give serious attention to this proposal in the context of its ongoing reforms to the foundation laws for public financial management.

24. **The adoption of the parliamentary appropriations basis of budgeting is the most important PFM reform opportunity facing the government today.** Its adoption will enable many of the other outstanding improvements to take place in a logical and supportive financial systems environment. It should be accorded the highest priority for funding and for implementation. However, this would need to be accompanied by capacity building for budget preparers, MOF and the appropriate parliamentary committees.

B. **Budget Execution**

Recent Progress

25. **The Government agreed with development partners on a series of Treasury reforms designed to improve the efficiency of budget execution.** The IMF, the World Bank and other development partners had been unanimous in recommending the establishment of a central and regional Treasury organization within MOF to improve: budget execution control; daily financial planning and cash management; accounts payable payment arrangements; and short-term debt management to support cash management. They also recommended the use of a Treasury Single Account (TSA) for banking of all budgetary and extra-budgetary resources to maximize the government’s cash management capacities.

26. **The government has made sound progress in implementing these reforms:** The PFM reforms resulted in the creation of the Treasury function and the specification of its functions and operations.

- Operationally, the government: established payment and commitment controls for central and local government budgetary transactions; extended these controls to extra-budgetary transactions and the transactions of stand-alone funds; closed all of the extra-budgetary bank accounts maintained by budget organizations.

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9 See Chapter VII on External Oversight.
10 As of June, 2010, these were largely complete. There are three large funds that have not been consolidated.
Functionally, these reforms included: the assigned Treasury functions; the legal framework for the establishment and operation of the Treasury; the Treasury organization and a delineation of its relationships with other organizations; the technology plan for the Government Financial Management Information System; a Treasury training plan; the Treasury budget and financing; and the risks, risk mitigation strategies and critical success factors.

27. **This was followed closely by the 2004 Law on the Execution of the State Budget.** This law incorporated into the Treasury Single Account (TSA) all accounting for execution of the State Budget and also brought in the extra-budgetary State Targeted Funds and extra-budgetary funds of budget organizations. As a result, the TSA in designed to include transactions relating to all revenues and expenditures of the State budget and extra-budgetary funds. A 2007 presidential resolution, defined the core responsibilities of the new Treasury unit, made mandatory the registration with Treasury of all budget-funded contracts with suppliers of goods and major construction contracts; and assigned it the responsibility of servicing internal and external national debt and the execution of national guarantees (Box C refers).

<table>
<thead>
<tr>
<th>Box C: Recent Budget Execution-Related Legislation and Orders</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Law on Execution of the State Budget (#664-II/2004)</td>
</tr>
<tr>
<td>• <em>Minister of Finance Order</em>, On Approval of Revenue, Expenditure (Functional and Economical) and Fund Classification of the State Budget (#80/2008)</td>
</tr>
</tbody>
</table>

28. **The 2008 order of the Minister of Finance established the specific budget classification codes and structures.** This will be fully implemented by all ministries, departments and agencies beginning in the 2011 budget year. In terms of budget execution, the new coding structure facilitates the reporting of the results of the execution of the annual budget by enabling an integration of the comparison of budget vs. actual expenses and revenues at a disaggregated level of detail. This provides insight into the ability of the budget entity to manage its budget and to respect the levels of authorization granted by parliament.

**Analysis**

29. **The Treasury Department has established itself as a key function in budget expenditure planning and control.** Parliament and the government have provided the legal framework in which the Treasury can operate, and this is well on the way to being implemented. In terms of scope of transactions now covered by the Treasury, the only major general government sector components outstanding are tax revenues, some security agency transactions (2% of budget organizations) and a few stand-alone funds. A decision has been made for the Treasury to cover tax revenues and the remaining security agencies, but for technical reasons this cannot be done until the implementation of the GFMIS, currently being procured. Three of the

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standalone funds present difficulties - two for reasons of state security and one (the FRD) because it was established by the authorities in the belief that it would not be consolidated into the TSA.\textsuperscript{12}

*Funds Predictability*

30. **With the establishment of the new Treasury system complete information on individual budget organization transactions has become more reliable and predictable.** This includes budget organizations’ expenditure commitments on contracts, planned spending and actual payments. The spending ministries now prepare their *smetas* (i.e. *their budget estimates*), an annual cash flow utilization forecast, for their approved budgets, broken down into monthly allocations. The *smetas* are submitted to the MOF and the Treasury where they are registered in the expenditure control system. The *smetas* are planned to be implemented in the 2011 budget cycle according to the government’s new *GFSM 2001*-based economic classification structure,\textsuperscript{13} which will also be reflected in the new unified chart of accounts for the general government sector.

31. **The approved smeta is the basis for in-year spending control exercised by the Treasury.** There are few volume changes to the budget organization’s approved budget and *smeta* initiated by the MOF. Most MOF changes are for salary increases and inflation adjustments. Budget organization changes are to accommodate operational changes or for new policies introduced by the government. The days of unpredictable cash rationing by MOF because of overall fiscal problems appear to have largely ended. Budget entities are in a substantially better position to manage their budgets more efficiently than in the pre-Treasury era. The rating of this volatility sub-component is a B.

32. **While there is close monitoring of cash because of the Treasury controls over most bank accounts there is no effective cash planning.** This is the next major step in the treasury evolution. The rating for this sub-item is therefore a C, until such cash planning processes are put in place. The global PEFA performance for the funds availability for the commitments of ministries indicates a C+.

\textsuperscript{12} However, the FRD appears to meet all the requirements for consolidation.

\textsuperscript{13} The classification and coding system is compatible with the IMF’s GFS 2001 standards.
PI 16: Predictability in the availability of funds for commitments of expenditures

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Extent to which cash flows are forecast and monitored</td>
<td>C</td>
</tr>
<tr>
<td>2. Reliability and horizon of periodic in-year information to Ministries,</td>
<td>A</td>
</tr>
<tr>
<td>Departments and Agencies on ceilings for expenditure commitment</td>
<td></td>
</tr>
<tr>
<td>3. Frequency and transparency of adjustments to budget allocations that are</td>
<td>B</td>
</tr>
<tr>
<td>decided above the level of management of the Ministries, Departments and</td>
<td></td>
</tr>
<tr>
<td>Agencies</td>
<td></td>
</tr>
</tbody>
</table>

Aggregate Rating: C+

Management of Cash Balances, Debt and Guarantees

33. **The PEFA indicator has three components relating to cash and debt management and related guarantees.** The availability of timely information on all external debt obligations is a prerequisite to sound management of this important liability. The management of cash resources is essential component of ensuring the availability of cash to finance ongoing operational activities and to meet periodic debt related payment requirements. In addition, loan guarantees are contingent liabilities of the State and as such should be closely controlled and monitored.

34. **It was not possible to get the required information from MOF Loans Department to assess their debt management capacity.** As a result, the team was unable to assess the debt management component of the relevant PEFA indicator, as shown by the Not Rated (NR) assessment in the table below.

35. **The government has made good progress towards establishing a TSA system.** This is the second component of the PI-17 indicator. Most budget organization bank accounts have been closed, and most general government sector transactions are processed via Treasury bank accounts. However, the Treasury bank accounts cannot be consolidated into a TSA system until the GFMIS is implemented. As a result, its current rating is B.

36. **The final component addresses the systems for contracting loans and issuance of loan guarantees.** Internal and external borrowings represent the principal liabilities of any government and timely and complete information on each obligation is critical to its effective management. In addition, loan guarantees can be a large contingent liability for governments, particularly if they are not well regulated. The preferred solution is to have all guarantees approved by the Minister of Finance or by the Cabinet of Ministers and to provide an appropriate disincentive for ministries to unnecessarily propose such guarantees as though they are without cost to the government. The government has confirmed that the system for managing loan guarantees is understood by all budget organizations that deal in the area, and that compliance is good.\(^\text{14}\)

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\(^\text{14}\) There are many examples in other countries of cases where such guarantees became unexpectedly due, resulting in large liabilities that caused extreme disruption in the fiscal framework.
37. There are a number of criteria for establishing limits for contracting loans and issuing loan guarantees. They include national forecasts for exports and foreign exchange revenues, capital investment needs and the current status of the debt portfolio (existing debt levels and maturity schedules). The PEFA rating for the debt and cash management and recording function is NR. This reflects the absence of any information from MOF on the quality and completeness of the government’s debt obligations and the availability of the relevant reports.

PI 17: Recording and Management of cash balances, debt and guarantees

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Quality of debt data recording and reporting</td>
<td>NR</td>
</tr>
<tr>
<td>(2) Extent of consolidation of the government’s cash balances</td>
<td>B</td>
</tr>
<tr>
<td>(3) Systems for contracting loans and issuance of guarantees</td>
<td>B</td>
</tr>
</tbody>
</table>

Aggregate Rating | NR

NR = not rated

Recommendations

38. The MOF should consider requesting the Cabinet of Ministers, at an appropriate time, to approve the phased implementation of appropriation-based budgeting for all aspects of its budgeting and reporting systems.

39. The MOF should maintain up to date information on the government’s debt obligations and such information should be readily available as part of fiscal reports of government.

III. ACCOUNTING, RECORDING AND REPORTING

A. Accounting

Recent Progress

40. The accounting practiced by the different levels of government varied considerably. Budget organizations used accrual accounting by means of the original chart of accounts designed under the former Soviet Union in 1987. Budget execution cash releases were covered in a separate Chart of Accounts for line ministries and another for releases by financial departments in the regions using the cash basis of accounting. Most were manually operated.

41. Multiple Charts of Account used by different bodies for particular classes of transactions resulted in a number of shortcomings, including:

- accounting for expenditure by the MOF was based on cash transfers to line ministries;

15 While levels of debt and loan guarantees had been in a stable level for past years, the 2010 year was unusually high, reflecting significant pent up demands for projects in water supply, energy, and environmental projects.
• extensive time gaps between the occurrence of a transaction and its reporting to MOF made it impossible to manage arrears;
• revenue-matching principles differed between MOF and its regional offices\textsuperscript{16}
• fragmentation of the accounting system made reconciliations very cumbersome, reducing data quality and hence control, and prevented full consolidation; and
• the accrual accounting deviated from international accounting standards, which would over time cause government accounting in Uzbekistan to deviate from private sector accounting and from government accounting in other countries, with consequent problems for analysis, decision-making and training.

42. **The government has taken steps to address accounting improvements.** The new coding structure for the classification of transactions for the general government sector will be completed when the GFMIS is implemented. The adoption of accrual-based accounting that is compliant with international standards has been included in the Minister of Finance-approved PFM Strategic Plan. However, no formal decision has been taken to ensure that is a firm policy decision of the government. Once the accompanying instructions have been completed and submitted to the Ministry of Justice for approval, the necessary legal basis for the introduction of the chart of accounts will be in place. Only then can the long implementation process for accrual accounting begin.

43. **The implementation of the Treasury function permits prompt relevant and more comprehensive accounting.** As part of the Budget Systems Law amendments for the Treasury, a complementary accounting period was defined for end of year transactions to ensure that most transactions pertaining to the financial year just ended are accounted for in that year and that all those transactions pertaining to a year are set off against the budget appropriations for that year and that the closing cash balance for the year reconciles with the bank reported by the Central Bank.

44. **The MOF strategic plan represents the MOF’s present intentions for accounting reforms but not necessarily those of the government.** Pending this approval, the following three phases in implementing accrual-based accounting have been identified by MOF:

- **Phase 1 - FY 2011\textsuperscript{17}:** include the former accrual accounting of revenues and payables practiced in the past; account for foreign currency gains and losses, implement segmented geographical supplementary reporting and account for taxes and duties using the IPSAS standards. Wherever possible provide supplementary disclosure of all available IPSAS-based financial information on a supplementary basis for all accounting changes not yet implemented into regular accounting and reporting procedures.
- **Phase 2 - 2012-2015:** identify and disclose contingencies in budget reports, record employee benefit liabilities and pension fund liabilities and assess and record heritage assets using IPSAS methodology.
- **Phase 3 - 2016-2017:** value and book real property holdings and the associated annual depreciation charges by class, equity account for the Central Bank and government owned and controlled enterprises disclose related-party transactions, change from equity-based consolidation to full, line-by-line consolidation of all government owned and controlled.


\textsuperscript{17} Given that the COM has yet to approve the move to accrual accounting, it is highly likely that this target date will slip somewhat.
enterprises and use additional segmented reporting to all government owned and controlled business enterprises

By the end of 2017, the Strategic Plan forecasts that Uzbekistan will have fully implemented IPSAS accrual accounting for all government activities.

Analysis

45. **The MOF is now able to account fully for all the transactions between the various levels of government and the Central Bank.** Consolidated reporting, to the extent it was possible, was a difficult, manual process in the past. For this reason, as an interim step, a new unified chart of accounts that is compatible with the IMF’s GFS 2001 standard was formulated and adopted\(^\text{18}\). It was designed for use by all levels of government, for both budgeting and budget execution purposes. This facilitates consolidation, aggregated reporting and a ready comparison of financial performance by examining budgets and actual performance on the same basis.\(^\text{19}\)

46. **The full implementation of the new GFS 2001-based budget classification by 2012 will provide more detailed information for the government**\(^\text{20}\). This date accommodates the changes to the budget preparation and execution systems and training of relevant officials that are now being completed. The pilot approach for implementation was followed because of the need for user training in the new classification framework. The pilot has been established in one district of Tashkent City, in parallel with the existing classification. The new budget classification will be fully implemented for the 2012 Budget.

47. **The government’s PFM Reform Strategy for 2007-2018 contains a description of the broad schedule for a multi-year accounting reform package.** This would require a substantial upgrade of the supporting financial systems that capture and process financial transactions and a new chart of accounts to support the accrual basis. It will move the government budget entities from a modified cash basis (Soviet-era accrual) of accounting to a full accrual basis, according to International Public Sector Accounting Standards (IPSAS). The proposed reforms are ambitious but well thought out. Also, the phased development of modern public sector accounting and financial reporting as an integral part of the Treasury reforms and based on IPSAS is an approach that could promote greater accountability and transparency.

48. **Few countries in the world have adopted full accrual based accounting and this should be viewed as a long-term goal.** The Government should ensure that technical reforms do not get ahead of institutional reforms and implementation capacity. The Government has not yet officially approved the phased adoption of accrual-based accounting for the budget sector. There has been little progress to date in meeting the target dates laid out in the PFM Strategic Plan. This should be addressed by an appropriate decision of the government and an accompanying Resolution should establish this decision.

49. **The majority of bank accounts for central government are under the control of Treasury.** The Treasury now controls the bank accounts of the Customs Agency, while the bank accounts of the Tax Agency are maintained separate from the Treasury, but plans are underway to have these included in the near future. The treasury now also controls the bank accounts of

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\(^{18}\) Chart of Accounts that complies with GFS 2001 has been implemented from January 2011

\(^{19}\) ADB, *Project Report #41041*, p. 27, June 2007.

\(^{20}\) 2011 budget formulated on the basis of the new budget classification that complies with GFS 2011 requirements
Budget Organizations (including their extra budgetary funds), most State Targeted Funds and other Extra Budgetary Funds. This represents roughly about 2,000 bank accounts of which 214\textsuperscript{21} are main Treasury bank accounts and the rest are transit bank accounts\textsuperscript{22}. By far the most transactions are processed through the main Treasury accounts.

50. **Bank reconciliations for all central government bank accounts are done on both an aggregate and detailed level and within the following time frames:**

- Tax and Custom Authorities bank accounts are reconciled once a month, usually within a week of the end of the period;
- 47 of the 214 main Treasury bank accounts are reconciled daily at the end of the day through an electronic bank-client system;
- the remaining bank accounts are reconciled manually the next business day with banks statements received from either the central bank or commercial banks;
- at the aggregate level, the TSA is reconciled by the Central Office of the Treasury on a daily basis with information provided by the central bank as a control measure over the reconciliation of regional bank accounts.

51. **Suspense accounts are reconciled at least quarterly and are cleared within one month from the end of the quarter by the respective central and regional Treasury units.** Advances to staff are recorded as settlement accounts and monitored by the accountant of the BO to ensure repayment of the outstanding debt. As a result of the MOF’s sound bank reconciliation practices, the highest PEFA indicator rating has been assigned.

**PEFA Score for PI 22: Timeliness and regularity of accounts reconciliation**

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Regularity of bank reconciliations</td>
<td>A</td>
</tr>
<tr>
<td>(2) Regularity of reconciliation and clearance of suspense accounts and advances.</td>
<td>A</td>
</tr>
<tr>
<td><strong>Aggregate Rating</strong></td>
<td>A</td>
</tr>
</tbody>
</table>

**Recommendations**

- The MOF should consider requesting the Cabinet of Ministers, at an appropriate time, to approve the move to international accrual accounting and begin the implementation of the initiative in the three proposed phases outlined in the MOF PFM Reform Strategy.
- The government’s accrual accounting standards should be fully compliant with the IPSAS standards for the public sector.

**B. Government Financial Management Information System**

**Recent Progress**

52. **The need for a modern government financial management information system had been recognized from the early days of PFM reform activities.** The IMF had strongly supported its development in a series of recommendations relating to its design and implementation, beginning in 2003 and continuing to date. Other relevant material can be found

\textsuperscript{21} A total of 199 accounts are for the Rayons, 14 for Oblasts and 1 is a central Republican account.

\textsuperscript{22} For the transfer of cash to Budget Organizations that do not handle cash themselves.
in the 2003 Public Financial Management Reform Program\textsuperscript{23}, the Bank’s 2004 CFAA and the Public Expenditure Review both endorsed the previous IMF recommendations for the GFMIS, and the Public Financial Management Reform Project (2005) dealt extensively with the requirements for such a system. The government accepted all of these recommendations as an integral component of its comprehensive Treasury reforms.

53. **Prior to the implementation of a full function Government Financial Management Information System the Treasury Department had developed an interim system.** Two releases have been already completed, with a third release expected in the current fiscal year. While providing some of the required functionality, it will be replaced by the GFMIS that will provide all the required functionality in a modular format that permits each module to operate with other modules of the overall system.

54. **The acquisition of the GFMIS is currently in the mid-procurement stage.** The RFP was issued in December 2009 under ADB procurement procedures and vendor responses are due by the end of April. The plan is to complete negotiations and sign a contract by September 2010. The planned duration of the work is 420 days (14 months). The final contract will confirm or adjust this estimate.

Analysis

55. **The functional requirements for the GFMIS are typical of all similar systems acquired by other governments.** The core functionality consists of a general ledger system that utilizes the accounting policies and the chart of accounts recently adopted by the government for the budget and budget execution, an accounts receivable and an accounts payable module. This generally comprises the first phase of implementation of the GFMIS. It also involves changes to the government’s processes to take advantage of the increased efficiency of processing resulting from the system capabilities.

56. **Other modules can be added in subsequent phases.** These include revenue accounting, budget preparation, supplementary budget preparation, accrual accounting, cash management, procurement, human resource management, asset management, inventory control, debt management and project accounting. The selection and timing of these modules and their related process reforms are a future decision of the government, after having considered its experience with this first phase of implementation.

57. **All major IT systems projects in both the private and public sectors in many countries present major risks to successful implementation.** A Standish Group industry-wide study\textsuperscript{24} of a large sample of major systems implementation projects in the private and public sectors found a very low success rate. The study defined success as achieving the full system functionality, installed on time and within budget. Other projects experienced major adjustments in timing, scope and/or cost, or were abandoned. Their analysis of the 2009 results from major systems projects indicated that only 32\% of projects were successfully completed, while 44\% were subject to major adjustments. As well, 24\% failed and were cancelled prior to completion or never used.

58. **The key success factors contributing to the GFMIS project, as for all major IT

\textsuperscript{23} It contained a set of recommended functional requirements for a GFMIS to cover commitments and expenditure processing.

\textsuperscript{24} Standish Group, *CHAOS Summary, 2009* at www1.standishgroup.com
projects, are well known in the IT industry. They include: strong user involvement in the project; a capable project manager who remains on the project throughout implementation; strong and continuing executive management support; a clear statement of scope and requirements; a total ban on “scope creep”; 25 proper implementation planning and realistic deliverables. 26

59. User involvement: in many cases, there is insufficient involvement with the ultimate users of the system as to what their needs are from the new system. If there is only a perfunctory consultation, the users will be unhappy when it comes to the user acceptance tests, and the project may falter.

60. Capable project manager: Particularly in governments, the project manager may not be experienced in major systems development and implementation. This places the successful execution of the project at major risk, even if the contractor is experienced. Another weakness is that there can be a succession of project managers, so that none of them are accountable for the decisions made during their tenure in charge.

61. Strong executive management support: This is essential to the success of the project. The strong executive sponsor of the project must be able to resolve conflicting views and defend the project from those who want changes or other “improvements” or who oppose the concept. The projects invariably involve major changes in the processes and culture of the implementing organization. This strong executive must also be the champion of change within the organization.

62. Clear scope and requirements: without a comprehensive and definitive statement of exactly what the project will deliver, those who have differing interpretations and expectations as to what will be delivered and what the finished system will do will threaten its implementation.

63. No scope creep: An ever-expanding scope of a project results in additional work, longer implementation times, missed deadlines and increased costs. When the expanded project is completed, critics will look at the “failures” of the project in terms of time and cost overruns.

64. Proper implementation planning and realistic expectations: Proper planning that fully involves all affected parties will go a long way to informing the organization about the expected outputs. The plans for implementation require a careful identification of tasks, responsibilities, resources, durations of tasks and deadlines to support good project management.

Recommendations

- MOF should ensure that an experienced IT project manager is appointed to act in this capacity for the life of the implementation of the project;
- MOF should ensure that there is an active and highly-visible executive sponsor for the project and a well-developed project plan with clear deliverables and target dates;
- There should be continuous consultation and involvement of the users of the GFMIS during its planning and implementation.


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25 Scope creep occurs when the scope of the project is expanded and deadlines are revised as a result.
26 The issues associated with these risks were discussed with the GFMIS project manager, who confirmed their validity with the team.
C. Reporting

65. The objective of government financial statements is to provide information about the financial position, financial performance and cash flows that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management’s stewardship of the resources entrusted to it.

Recent Progress

66. The implementation of the Treasury function permits relevant, timely and more comprehensive reporting. This allows decision makers to respond quickly to reported changes in the budget and fiscal environment. It also enables regular reporting to the public and parliament, potentially enhancing accountability and transparency. The Budget Systems Law amendments also required specific disclosures in the annual reports of budget organizations. These reports should indicate: commitments carried forward to next year; accounts payable and accounts receivable at the start of the new fiscal year; and a statement of contingent liabilities. The annual report should identify those unused budget funds that were transferred to the budget organization special accounts (development funds).

67. The currently planned reforms to government reporting tend to be longer term in nature. They relate to projects to implement accrual based accounting changes and the accompanying GFMIS. For example, the statement that aggregate budget execution reports should comply generally with IPSAS cash basis of accounting and GFS 2001 classification is being implemented for the 2010 fiscal year end reports. In 2011, MOF expects that it will prepare supplementary disclosure in the budget execution reports of accrual financial information according to GFS2001 and IPSAS accrual accounting, including segmented analysis of sub-national governments. Revenues will be classified in the 2011 financial year. Further disclosures of all liabilities, including employment related and contingent liabilities, pension funds balances and heritage assets accounts will occur in the second phase of the MOF PFM Reform Plan during 2012-2016. The disclosure of the governments real property assets (land and buildings) and equipment and other asset holdings will occur in Phase 3 of the reforms in the 2016-2017 period.

Analysis

In-year budget reports

68. Article 39 of the BSL requires monthly and quarterly reports on budget execution to be submitted within 5 days after the end of the period and is strictly complied with. This requirement applies to all Budget Organizations (including their extra budgetary funds), all State Targeted Funds, and other Extra Budgetary Funds as well as State Tax Committee and State Customs Committee. Monthly reports are provided at a more aggregate level by groups of expenditures while quarterly reports provide a detailed breakdown by item (viz. type, object, sub-object). Both reports allow for comparison of the approved budget to actual numbers. However, expenditures are covered at payments stage only and not yet at commitment stage.

69. For the quarterly reports the individual Budget Organizations prepare their own income and expenditure statements and balance sheets that contain additional accrual

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27 This is done under the authority of COM Resolution 414.
28 The team requested, but was not provided with the actual budget execution reports to verify the information provided verbally.
information. This includes accrued expenditures, payables, receivables and disbursement reports. The MOF prepares monthly reports for budget organizations and aggregated quarterly budget execution reports\(^{29}\) from all the individual reports submitted that are submitted to the lower House of Parliament, the Oliy Majlis, for information and review.

70. **The reliability of the in-year budget execution reports is supported by financial process controls.** First, individual Budget Organization reports are submitted to Treasury, which is responsible to keep a record of cash receipts and payments made. The Budget Organization’s expenditure budget execution data is then reconciled with the Treasury information as a measure of control to ensure accuracy and completeness of financial information. Treasury would then provide confirmation of such reconciliation to the MOF. Staffs from CRU as well as financial officers perform checks of the reliability of the date from time to time. The relevant PEFA indicators are provided in the table below, showing aggregate rating for the quality and timeliness indicator of C+.

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Scope of reports in terms of coverage and compatibility with budget estimates</td>
<td>C</td>
</tr>
<tr>
<td>(2) Timeliness of the issue of reports</td>
<td>A</td>
</tr>
<tr>
<td>(3) Quality of information</td>
<td>A</td>
</tr>
<tr>
<td><strong>Aggregate Rating</strong></td>
<td>C+</td>
</tr>
</tbody>
</table>

**PEFA Score for PI 24: Quality and timeliness of in-year budget reports**

71. **The PFM system effectively supports front-line service delivery units.** This includes services such as primary schools, primary health care and other facilities that are providing services at the community level. Tracking of information on all types of resources received in cash and in kind is done on a quarterly basis (see Box D below). This information is compiled into consolidated budget execution reports and is regarded as comprehensive.

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\(^{29}\) This is done electronically through the application of GIIS software by aggregating information that is predominantly prepared by the individual organizations on the so-called BOOKKEEPING software.
Box D: Availability of Information on Resources Received by Service Delivery Units

**Primary schools.** These schools have the status of legal entities and operate as Budget Organizations. They are responsible for the purchasing of most school supplies and are subject to regional Treasury controls. Consequently, they are required to prepare monthly and quarterly budget execution reports as well as annual financial statements. Information about expenditures incurred is therefore prepared, submitted through local governments and eventually consolidated by the Ministry of Public Education. Requirements for in-kind resources to be delivered to these schools, e.g., text books are determined from a roster of requests submitted annually by the schools. The books are procured centrally by the ministry and are well monitored through the submission of delivery certificates by contractors who deliver it on behalf of the ministry. Statistics about these resources are consolidated and kept centrally by the ministry and provided in their annual report.

**Primary health care facilities.** More than 3,100 such facilities are provided with budget allocations through the Ministry of Health (MOH). They incur expenditures that are subject to regular regional Treasury controls. Information about expenditures incurred is therefore consolidated into the quarterly budget execution reports of the MOH. In-kind resources delivered to these facilities, e.g., coal and gas procured centrally by the MOH, are well monitored through the submission of acceptance certificates by the recipients for deliveries made by contractors on behalf of the ministry. Statistics about these resources are kept in a database and consolidated and kept centrally by the ministry and provided in their annual report. Reforms are underway to centralize the procurement and distribution of drugs and medical supplies that will be provided to these facilities in the same manner.

*Source: Ministry of Public Education, Ministry of Health*

As a result, the PEFA indicator is rated as A.

**PEFA Score for PI 23: Availability of information on resources received by service delivery units**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units</td>
<td>A</td>
</tr>
</tbody>
</table>

**Annual financial statements**

72. **The MOF submits aggregated government annual financial statements to the Cabinet of Ministers no later than April 1 of the next year.** The fiscal year is the calendar year. This report is prepared as an aggregation of the annual budget execution reports of all Budget Organizations (including their extra budgetary funds), all State Targeted Funds, other Extra Budgetary Funds and State Tax Committee and State Customs Committee entities. The financial results from the government’s many Public Enterprises are excluded. At present, the Treasury records the cash receipts and payments, while the individual Budget Organizations prepare their own income and expenditure statements and balance sheets. The aggregation is done electronically through a software program that is also used for the aggregation of the in-year

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30 In accordance with article 39 of the BSL
budget execution reports. The Cabinet of Ministers sends this report to the Chamber of Accounts (COA) by April 5 for the purposes of external audit and evaluation.31

73. **The annual financial statements contain information of assets, liabilities, revenue and expenditure, but not on the full accrual basis.** Information such as contingent liabilities and other information that are typically required by IPSAS are not yet included in this report. Also, Budget Organizations are allowed by legislation32 to pay accrued expenses within one month after year-end and record these payments as expenses prior to year-end — consequently they are not disclosed as payables on the balance sheet. While the new chart of accounts has been finalized, the accounting framework that needs to be adopted in the design and implementation of the GFMIS is yet to be fully documented. More information about the government’s envisaged reforms and implementation of IPSAS is provided in the Accounting section of this chapter. The IMF has expressed concerns about the quality and the completeness of the information provided for their national financial statistics data collection activities. The Treasury reforms are a partial remedy for this situation. The global PEFA rating of C+ has been assigned.

<table>
<thead>
<tr>
<th>PEFA Score for PI 25: Quality and timeliness of annual financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sub Indicator</strong></td>
</tr>
<tr>
<td>(1) Completeness of the financial statements</td>
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<tr>
<td>(2) Timeliness of submission of the financial statements</td>
</tr>
<tr>
<td>(3) Accounting standards used</td>
</tr>
</tbody>
</table>

| **Aggregate Rating** | **C+** |

**Access to External Reporting**

74. **The government closely controls the disclosure of all financial and economic information.** It was not possible to access selected budget information from MOF, and there appeared to be a general reluctance for greater dissemination of such information, whether to development partner missions, external lenders or even the IMF for its International Financial Statistics. The IMF has reported data inconsistencies and has expressed concerns about the accuracy of selected government macroeconomic measures.

75. **Greater transparency in the government’s financial operations would have several benefits.**33 It would benefit the government in its dealings with the international community as well as its citizens. Many countries have now placed their budgets and budget execution reports on their MOF website without any problems arising. Even Parliament itself could benefit from the online access to government budget information and the resulting increased ability to get the information they require for their oversight responsibilities. Such increased disclosure could also improve its standings in other assessments conducted by the Bank and others. This includes the CIFA, the CAS and the CPIA reviews, all of which depend to a significant extent on the availability of transparent financial data on government operations and its fiscal parameters. The government should take steps to increase the scope and quality of financial information disclosed to the international community, Parliament and the citizens of Uzbekistan.

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31 See the following chapter for more details.
32 Authorized under the Treasury Systems Law and COM Resolutions 414
33 Given the reluctance of the government to implement enhanced transparency, it is apparent that they do not share the team’s views on its benefits.
Use of Country Systems

76. **Development partners have recognized the importance of increasing the effectiveness of international assistance.** The Paris declaration identified a number of areas of attention one of which was the need to “increase alignment of aid with partner countries’ priorities, systems and procedures and helping to strengthen their capacities.”\(^{34}\) In the areas of PFM and procurement, this has translated into an emphasis on identifying opportunities within countries to utilize their existing systems to meet the Bank’s requirements for effective fiduciary management of project implementation. The objective is to increase the use of in-country systems.

77. **There are a number of advantages to the use of in-country systems.** It provides an opportunity for: the development of staff capacity in financial and procurement management of projects; increased government involvement, commitment and ownership in the Bank-financed projects; the identification of future areas for enhancement of existing in-country systems; reduction in the overhead cost of project management and control.

78. **The World Bank has increased its flexibility in adopting in-country system applications.** It now supports the use of acceptable components of a country’s financial management system, where this is possible. This could cover such components as budget accounting and control, reporting, internal control and internal or external audit.

79. **With the establishment of the TSA and the consolidation of the many extra-budgetary accounts and funds, the Treasury system is in a position to begin to manage the ex ante spending controls over the budgets of Bank-financed projects**\(^{35}\). While the Bank has in the past suggested to the government to pilot the use of Treasury system in a Bank-financed project the proposal was deferred. Now that the treasury system has attained operational status, it is useful to revisit the idea.

80. **The team believes that there is an opportunity to use a component system of the government in the control of a Bank-financed project.** The pilot involving a line ministry implemented project could be reconsidered. As described in this report, the current treasury system is capable of providing the accounting, *ex ante* budget execution control and the reporting for a pilot Bank-financed project. This would eliminate the need for an independent accounting and reporting system for the project. Specific Bank requirements for reporting could be addressed in the current treasury system, following successful negotiations with the Treasury. Project planning and the budget formulation activities would continue to use Bank processes until revised budget preparation procedures have been incorporated into a subsequent release of the treasury system, and external audit would continue to be conducted by eligible private sector audit firms pending satisfactory capacity enhancement of the Chamber of Accounts.

**Recommendations**

- Quarterly budget execution reports should be in a single report that includes information at both the commitment and the payment stage of expenditure to allow for more meaningful monitoring of budget implementation and utilization of funds released.

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\(^{34}\) *The Paris declaration for Aid Effectiveness*, p. 1, 2005.

\(^{35}\) This would require the agreement of both the government and the development partners to use the TSA for the banking needs of their projects.
• The instructions for detailed application of the new accrual accounting framework by Budget Organizations, including the phasing of the implementation of the framework, should be fully developed by MOF and promulgated to all budget organizations.

• MOF should ensure that all of its staff, Treasury staff and the local and regional Finance and Treasury staffs receive training on the accrual accounting and financial reporting reforms being implemented. Financial reporting should be an integral part of the MOF strategy of communications and training on the Treasury reforms.

• The government should take steps to increase the scope and quality of financial information disclosed to the international community, Parliament and citizens on a regular basis.

• The government should work with the World Bank to develop an approach to partial use of its budget control system for Bank-financed projects.

IV. PUBLIC PROCUREMENT SYSTEMS

81. The procurement activities of any government are a substantial component of its total expenditures and require prudent management. The team was unable to obtain any estimate on the value of goods, services and capital assets acquired in a recent fiscal year. However, with the full introduction of the new chart of accounts for all budget preparation and budget execution activities, the acquisition of such data will become routine. It is clear that a significant component of government non-salary spending is devoted to its procurement activities.

82. The procurement assessment in the CIFA is not a detailed assessment normally employed in a CPAR. The more detailed methodology\(^{36}\) was considered at the concept stage but decision was made not to use it mainly due to the following reasons:

• it is quite complicated and is by itself a stand-alone exercise; it is not advisable to mix it with the PEFA methodology which is the main approach agreed for the CIFA;
• the limited availability of public procurement data in the country would make the detailed assessment very difficult; and
• the underdevelopment of the public procurement system in the country would make a more detailed assessment neither appropriate nor meaningful.

83. Instead, a more limited analysis was undertaken and then summarized in a single PEFA indicator. However, the mission examined the procurement function using the four main procurement pillars as a guide for their work. They include the: legislative and regulatory framework; institutional framework and management capacity; purchasing operations and market practices; and integrity and transparency of the public procurement system.

84. International standards exist for a sound public procurement system that could be adopted by the government. These standards feature:

• the existence of a comprehensive legal framework that regulates public procurement in the country (such as a public procurement law based on UNCITRAL model law);
• the existence and well-functioning of an independent public procurement agency overseeing the public procurement;
• the effective operation of the system and high level of competitiveness of the national market

\(^{36}\) OECD/DAC is the most commonly employed procurement assessment methodology.
the implementation regulations and procedures are in place and enforced; and
- high integrity of the procurement system, including:
  - full transparency of the procurement system
  - regular and comprehensive reporting,
  - open information access to public,
  - effective complaint handling mechanism

85. **In 2002 the Bank and ADB carried out a joint country procurement assessment for Uzbekistan.** The assessment revealed that the public procurement system in the country was substantially underdeveloped and procurement practices were not cost-effective and were susceptible to fraud and corruption. The report listed the weaknesses of the public procurement system as: the absence of an unified legislative framework; inefficient and non-transparent procurement practices; the absence of a single institution with oversight or regulatory authority over public procurement; an underdeveloped system and weak capacity for handling procurement complaints; the absence of independent scrutiny of procurement contracts; the lack of comprehensive anti-corruption measures; and the low level of skills and capacity of the staff handling public procurement transactions at every administrative level. The report also found that private sector suppliers and contractors were very unsatisfied with the rules governing public procurement and had little confidence in the fairness of the system and the ability of the procuring entities to conduct the procurement transparently and efficiently.

86. **The CPAR provided a number of critical recommendations for improvements to the Public Procurement System.** These included: enact a Public Procurement Law together with a set of implementing regulations, standard bidding documents, and evaluation reports; the use of standard contract forms and conditions should be mandatory for all procuring entities for procuring works, goods, and services; establish a regulatory agency on public procurement to review bidders’ appeals; develop and implement a procurement capacity-building plan to build in-country capacity in procurement; and establish internal audit units within all ministries and budget organizations to audit the control system as well as conduct regular internal ex-post audits of random procurement operations.

87. **This chapter discusses the progress made in public procurement since the 2003 CPAR.** It describes progress made in the day-to-day procurement decisions made by procuring entities. For contracts above the threshold of US$100,000, a tender committee must be formed by the procuring entity with members from MOF, MFERIT, a commercial bank and others to administer the competitive tender. A working group and an expert group may assist this committee in its preparations of the tender specifications and for the bids evaluation. For those contracts greater than US$ 1 million, the approval of COM is required.

**Recent Progress**

88. **Some progress has been made in procurement reform**. This includes a change in the reference price base for cost estimation purposes from a 1991 cost base to a 2004 cost base. While no further changes to the cost base have been effected, contingencies were also added to the cost estimation procedure in 2004. The use of private sector design institutes was also permitted in 2004. Ex ante MOF controls were implemented and MOF now conducts price

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37 Article # 9, COM Resolution #456/2009 and COM Resolution #302/ 2003 apply to goods & services and civil works respectively.

38 Includes the creation of Commission for Public Procurement with the objective of ensuring transparency in public procurement.
verifications of all high-value procurements. As well, the frequency of CRU ex post inspections of procurements was increased, as were examinations by The Chamber of Accounts. Changes in the procurement processes ensured a separation of functions in all procurement entities by involving the entity’s financial officer in the approval process. Clearer rules were elaborated for situations where “single source procurement” is permitted, for procedures for small contacts (those between US$10 thousand and US$100 thousand) and for the application of the domestic preference procedure.  

89. **Significant reforms remain outstanding.** Previous CPAR recommendations for a new system for procurement have yet to be addressed. Outstanding recommendations for the government to consider include the following:

- develop a revised Law on Public Procurement that meets international procurement standards
- develop and implement the enabling procurement regulations and procedures;
- create an independent Public Procurement Agency for the development of procurement policies and regulating the procurement process government-wide;
- establish a separate procurement appeals process to accept and review complaints against the conduct of procurement activities by procuring entities;
- adopt internationally-compliant standard bidding and contractual documents and issue COM regulations making the use of these documents compulsory;
- designate a government agency/committee for procurement monitoring and evaluation, including: collection and consolidation of data on procured goods, services and works and preparation of procurement statistics and reports

90. **The preparation of a new Public Procurement Law has recently been initiated.** This was a key recommendation of the 2003 CPAR that was recently begun by a 12-person inter-ministerial committee led by the Prosecutor General’s Office. The team was unable to get any assurances as to the nature and content of this draft law, due perhaps to the early stages of the work. However, it did not appear to have taken into account the recommendations of the CPAR as identified in the previous paragraph.

91. **There are no other significant reforms underway.** This is in part due to the lack of priority accorded to Public Procurement by the Government. As well, there is no single entity that has been given responsibility for procurement within the Government. Rather, many ministries each have a small piece of the puzzle. When all are responsible, no one is responsible, and there is no organization with the drive and the responsibility to make major procurement reforms happen.

**Analysis**

92. **The present public procurement system in place in Uzbekistan does not provide the government with good value-for-money for its purchases.** There are numerous, widespread examples of procurement problems reported by the CRU and the Chamber of Accounts auditors during their regular, *ex post,* audit activities. They provide regular, independent evidence that the current procurement procedures are not effective in regulating the government’s procurement activities.

93. **There are significant problems in the existing tender processes.** They include: the widespread use of single source contracting in situations where a tender is required by the

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39 Revisions to COM Resolution #456 on procurement levels and related procedures
regulations; inadequate or missing documentation to provide a rational for this deviation from established procurement regulatory requirements; absence of a standard set of documents for contracts, bidding documents or transparent procurement processes; no effective, independent procurement review agency to receive complaints and redress violations of procurement policy. Currently, suppliers fear retribution should they submit complaints and there is little likelihood of effective redress action should they persist in raising their concerns. As a result of these gaps, the PEFA indicator for procurement is rated as a D+.

**PEFA Score for PI-19: Competition, value for money in procurement**

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
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<tbody>
<tr>
<td>(1) Use of open competition for awards of contracts that exceed the nationally-established monetary threshold for small purchases</td>
<td>D</td>
</tr>
<tr>
<td>(2) Justifications for use of less than competitive procurement methods.</td>
<td>C</td>
</tr>
<tr>
<td>(3) Existence and operation of a procurement complaints mechanism.</td>
<td>D</td>
</tr>
</tbody>
</table>

**Aggregate Rating**: D+

94. **The above scores are assigned based on the PEFA scoring methodology and the existing situation in Uzbekistan.** For the sub indicator (1), the score corresponds to the situation of insufficient data existing to assess the method used to award public contracts. For the sub indicator (2), the score is consistent with the case where the justification for use of less competitive methods is weak or missing. As for the sub indicator (3), the score is based on the lack of a well-designed process for receiving and addressing procurement complaints in a manner that provides for timely resolution of complaints.

95. **Weak procurement processes have resulted in the imposition of Treasury ex ante financial controls.** The Treasury departments are responsible for the verification of the prices negotiated by the procuring entity and the supplier. Should these prices be found to be outside of the norms, the Treasury will refuse to register the contract and it is returned to the procuring entity for re-negotiation. The Treasury maintains a database relating to reasonable prices for a restricted number of commodities – primarily foodstuffs and drugs.

96. **Price verification procedures practiced by the Treasury may adversely affect the domestic competitive processes.** This procedure may introduce delays in the procurement cycle. While this can be a useful tool for combating corruption in the bidding process, it can also undermine the competitive process. However, the practice reflects the current deficiencies in the implementation of the procurement process. On balance, it would be wise to retain price verification until the procurement system is substantially improved, the competitive environment among suppliers is strengthened and corruption has been effectively brought under control.

97. **A similar concern exists with respect to the price verification applied by MFERIT for all contracts involving imported goods.** Regulations for the registration of all import and export contracts have resulted in MFERIT exercising price verification over all contracts prior to

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40 Price verification occurs after the contract has been signed. Changes in the prices resulting from this verification activity require modification to signed contracts. This erodes the validity of the initial process of the tender process.

41 Transparency International 2009 Corruption Perception Index ranking for Uzbekistan was 1.7 out of 10, ranking 174th out of 180 countries.
their certification. There are many cases where the delays in processing contracts have exceeded the 10 working days target specified in the regulations. Table 2 refers.

98. **The use of a pre-shipment inspection agent is a mandatory quality assurance mechanism.** They also are required to conduct the price verification prior to MFERIT’s own price assessment. MFERIT advised the team that the 500 IFI-financed contracts out of the total of 700 contracts submitted in 2009 contained no problems and were registered, albeit with significant delays for some contracts.

Table 2: Examples of MFERIT Price Verification Times:
Individual Education Procurement Contracts
As of 12 February 2010

<table>
<thead>
<tr>
<th>Contract Goods Procured</th>
<th>Date of Signing</th>
<th>Date Submitted to MFERIT</th>
<th>Date Registered by MFERIT</th>
<th>MFERIT Processing Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Equipment</td>
<td>15 Jan 2009</td>
<td>3 August 2009</td>
<td>12 August 2009</td>
<td>9 days</td>
</tr>
<tr>
<td>Visual Aids</td>
<td>19 June 2009</td>
<td>18 August 2009</td>
<td>5 December 2009</td>
<td>108 days</td>
</tr>
<tr>
<td>Distribution Materials</td>
<td>19 June 2009</td>
<td>18 August 2009</td>
<td>5 December 2009</td>
<td>108 days</td>
</tr>
<tr>
<td>Computer equipment</td>
<td>5 October 2009</td>
<td>24 December 2009</td>
<td>Pending</td>
<td>More than 50 days</td>
</tr>
<tr>
<td>Computers &amp; Printers</td>
<td>10 June 2009</td>
<td>18 August 2009</td>
<td>11 December 2009</td>
<td>111 days</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>5 October 2009</td>
<td>24 December 2009</td>
<td>Pending</td>
<td>More than 50 days</td>
</tr>
</tbody>
</table>

Source: World Bank

99. **The MFERIT certification process is non-transparent.** Their “final price expertise” standards used for assessment are not published, nor are the results of the processing times and deficiencies encountered for individual contract submissions. This has adverse consequences: there is an increased opportunity for corruption in the process. INTOSAI has stated that processes with multiple approval stages and non-transparent approval criteria are key contributors to increased incidence of corruption.

100. **MFERIT exercise of contract price expertise (verification) over IFI-financed procurement contracts is not in accordance with government regulations or IFI procurement rules.** Its exercise of price (verification) expertise is a legal requirement for all “import” contracts; it enables a signed contract to be put aside until the price terms have been negotiated to meet MFERIT’s concerns. However, the legally binding ADB and WB procurement rules preclude any such modification to the contract price after the contract award following a competitive procurement process. The Government had accepted the legal agreements signed for IFI-financed projects as International Agreements, and their terms and conditions prevail over the domestic laws and regulation. The IFI project related legal agreements, including the agreed procurement rules and procedures, should be strictly adhered to by the government and such projects should be exempted from the MFERIT review process.

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42 MOF, MFERIT and Customs Committee, Regulation #1588/July 2006. In some cases, delays of up to 6 months have occurred for contracts submitted by the Ministry of Education.
101. **A recent Bank analysis in Uzbekistan confirmed these issues in a ministry public procurement system.** It noted that the transparency of a public procurement system can be measured by the extent to which it: (i) gives bidders access to information and (ii) has a system for handling complaints about the procurement process, including administrative sanctions and criminal prosecution. The CIFA team found that Uzbekistan’s public procurement system is characterized by limited access to information and a lack of an effective complaints and appeal system.

102. **Non-Transparent Evaluation Criteria.** In Uzbekistan, the lack of clearly defined evaluation criteria and the absence of requirements for product quality in bidding documents can lead tender committees to make arbitrary award decisions. The evaluation committee can question or reject even a duly registered drug. For example, in 2005 during a consolidated tender for drugs, one bidder submitted a fully compliant bid for generic insulin that was registered prior to the bid being submitted. The tender (evaluation) committee awarded that company, which was the lowest bidder, a contract for only one-third of the quantity. This was done after the committee had opened and analyzed the tenders and despite the fact that the bidding documents had not mentioned the purchaser’s right to increase or decrease the quantities at the time of the contract award. The order for the other two-thirds of the insulin went to a long-time supplier of insulin to Uzbekistan. The tender committee based its decision on the need to lower the risk of purchasing a product that had not previously been used in the country, arguing that it would be dangerous to order an “unknown” product to cover an entire year’s insulin needs. Although the committee’s desire to “protect” consumers had merit, the way in which this was done discouraged bidders from participating in public tenders and undermined bidders’ confidence in the fairness, transparency, and consistency of the procurement process.”

103. **Price Verification.** However, the lack of clear procedures for price verification leaves plenty of room for subjective interpretations. Following the awarding of a contract, each procuring entity must submit a concluded contract to the MFERIT for approval. There have been occasions when the MFERIT required the procuring entity to renegotiate the prices contained in contracts that have been competitively awarded through open tender, and yet on other occasions the MFERIT has allowed sole-source contracts to go through the registration process with no question. The impact of price verification at a local level could not be assessed as it was not yet implemented at the time of this assessment.”

104. **Ineffective Appeals Mechanism.** Although there is an official mechanism for appealing against procurement decisions, it may not be very effective. The Ministry of Health’s Inspection Unit is in charge of reviewing all appeals and complaints, including those from bidders and suppliers. According to the Control Inspection manager, no complaints or protests from bidders or suppliers have been lodged in the last four years. However, the absence of complaints is not necessarily an indication that the system is functioning well. International experience and practice suggests that a lack of complaints can be an indicator of: (i) skepticism on the part of bidders about the probable effectiveness of a complaint resolution system; (ii) a lack of information among bidders on how a complaint should be submitted and how it will be reviewed, and (iii) a lack of adequate legislation and/or its enforcement.”

105. **There is no consolidated report on the government’s annual procurement activities or on its performance against approved performance and efficiency standards.**

Transparency is an important component of improving the procurement activities of the

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government. The team was unable to find summary information on government-wide procurement and the type of procurement employed for contracts above the threshold established by regulation. Only limited data were available for procurements using less than competitive methods.

106. **Development partners are unable to rely on any components of the country’s procurement system.** This conclusion is based on this assessment of the country’s public procurement system and the experience with the Bank-financed projects. Until the recommendations in this report are properly implemented and substantial procurement capacity building efforts have been made, little change is likely. To this end, the Bank stands ready to provide assistance to the Government.

**Recommendations**

107. The development and implementation of the policies and processes identified in this chapter will take considerable time to achieve. Some recommendations may be short term in nature and could be readily developed and implemented by the government. Others may be more long term in nature and require several years to complete. The important decision is for the government to recognize that a problem exists in Procurement, and that it endorses a series of specific reforms to remedy the problems.

- The MOF should consider requesting the Cabinet of Ministers, at the appropriate time, to establish a strong legal, institutional and regulatory framework for the conduct of its public procurement activities.
- The government should consider designating a government agency for procurement monitoring and evaluation, including: collection and consolidation of data on procured goods, services and works and preparation of regular procurement statistics and reports for government, suppliers and the public.
- The government should ensure that all of the IFI-financed projects are designated as subject to International Contract rules and are exempted from the MFERIT expertise reviews.
- The government should consider a review of the salary scales for PIU staff and establish a process whereby the salary scales are reviewed every three years.
- The government should clarify and publicize the MFERIT’s details on the application of their “import/export contract expertise”, also known as their contract review processes and criteria, employed in their decision-making on those contracts submitted for certification.
- The government should consider implementing a significant increase in the transparency of its procurement activities by the preparation of consolidated summary information and reporting on its procurement activities. This report could be prepared quarterly for the COM, and annually for the government, Parliament and the public, and should be subject to a regular review by CRU and an annual audit by the Chamber of Accounts.

V. **INTERNAL CONTROL AND AUDIT**

A. **Internal Control**

108. **In common with other FSU countries in the region, the concepts of internal control and internal audit are not well differentiated.** The words “control” and “audit” have been used interchangeably as though they meant one and the same thing. Internal control is a management tool used to provide reasonable assurance that management’s objectives are being achieved. It
also involves establishment of systems and procedures intended to secure effectiveness, efficiency and economy in the management of resources, and compliance with established rules and regulations. Thus responsibility for internal control system rests with management, and each head of governmental body must ensure that a proper and effective internal control structure is in place.

109. Internal audit, on the other hand, is performed by auditors responsible to the head of the entity, and involves examining whether the internal controls are working as established. Internal audit exists to ensure that the control systems do in fact address all risks, and that all risks are covered by these systems. Internal audit is, therefore, an essential component of a well-functioning internal control system.

110. The term internal control used within the Treasury suggests an organisational structure by itself. However, internal control consists of rules and procedures and sound structures that are well integrated in the public administration entities or agencies and designed to ensure that management objectives are being achieved. According to INTOSAI45, internal control should not be looked upon as separate, specialised system within a governmental organisation. Rather, internal control should be recognised as an integral part of each system that management uses to guide its operations.

111. INTOSAI has identified a number of components that must be included for effective internal control46:

- Accounting and reporting controls governing the accounting and reporting transactions;
- Physical assets controls to protect state assets (including procurement controls);
- Process controls, to ensure all actions are authorized;
- Performance monitoring, for economy, efficiency and effectiveness; and
- Financial controls over financial, administrative and budgetary activities.

The internal control framework in Uzbekistan lacks some of the above attributes.

Recent Progress

112. The introduction of the GFMIS is an important milestone that will contribute to strengthening control over spending by the treasury. Its focus is on financial controls over spending by the treasury, i.e., control over allocation of spending, expenditure processing, accounting and financial reporting (the so-called hard controls). There is also a requirement for improved controls over management of fixed assets, operational effectiveness and enhanced managerial accountability. The 2004 CFMA identified the need for the government to develop a strategy to bring the internal control framework into compliance with international standards. This should provide a roadmap to develop the necessary legislative and structural changes to accomplish it.

113. The effectiveness of expenditure commitment controls has improved with the introduction of the Treasury system. A computerized commitment system is in place and budget organisations maintain records of their commitments to ensure that they stay within their budgetary limits for the year. These commitment systems, however, do not commit cash as they

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45 INTOSAI: Guidelines for Internal Control Standards for the Public Sector. Internal Control Standards Committee at www.intosai.org
46 Ibid.
do not link to the Treasury system and cash is only released on a monthly basis.

Analysis

114. **The Treasury commitment software exercises commitment control at three levels.**

- *ex ante* controls that ensure that only contracts covered by expenditure smetas are registered;
- current controls that ensure that payment orders/invoices are in line with registered contracts; and
- *ex post* controls by way of regular budget execution reports

As noted above all contracts signed by budget institutions for procurement of goods and services are subject to mandatory registration that helps to control targeted use of budget funds, ensures performance of contract obligations, prevents arrears, provides consistency of contracts with expenditure smetas and establishes strict control over accounts payable for all legally binding contracts.\(^{47}\)

Payroll Controls

115. **The present payroll systems are predominantly manual and highly decentralised.** Specific, detailed information on Budget Organizations with automated payroll systems was not readily available. The team was advised that the Ministry of Finance and a number of other budget organizations have automated payroll systems. There is no centralized personnel database for government and none is envisaged, even within the implementation of the Treasury system. For example, the MOF personnel department maintains records only for the Central Office of the MOF and some core personnel at the territorial level whose recruitment is subject to approval of the MOF. There is no evidence of periodic reconciliation of payroll with personnel records either at the Ministry of Finance or other line ministry level.\(^{48}\)

116. **There is little integration between personnel records and payroll data and there is the risk that changes in personnel records and payroll may not be reconciled in a timely manner.** A Division within the MOF Personnel Department issues administrative orders on employment. These orders are used to update staffing tables for MOF that are then passed to their payroll section. This arrangement should ensure that changes are made in a timely manner, but with the decentralised database, monitoring is made difficult, if not impossible. Similar disconnects between central and regional HR records and pay lists exist in other ministries as well. Closer integration is required if effective payroll controls are to be exercised. It was not possible to rate the second dimension of the indicator, given the lack of certainty surrounding the monitoring.

117. **Responsible officials in the personnel and the payroll sections may not be adequately involved in changes to personnel records and payroll.** The extent of decentralisation, the large number of budget organisations and the complexity of salary calculations also weaken payroll internal control. These challenges may, however, be compensated by the strict controls established at the level of each organization where attendance

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\(^{47}\) However if a regular order is placed for the delivery of, for example, stationery, then the commitment system is not as effective. This is because, unlike legally agreed contracts, lesser values stationary and other similar purchases do not have well-defined commitments. The placement of an order for supplies is a daily activity and for these kinds of activities the commitment registration is still not fully implemented.

\(^{48}\) However, established staffing schedules, indicating vacancies, are attached to the expenditure smetas, and cash expenditure reports also include staffing numbers.
is monitored by the use of daily time sheets, maintained by a specially authorized official. The
time sheet is then approved by the head of the organization or unit and submitted to the
accounting division at the end of the month for accrual of the monthly payroll. In some
organizations, including the Treasury, attendance is monitored through the use of access cards.
The use of the magnetic access cards is, however, not widespread.

118. **There is no clear audit trail and no specific payroll audits are undertaken in the
ministries.** However, some of these may be covered during the normal inspections by the CRU.
Reports of CRU inspections were not made available to the team to determine whether their
reviews covered payroll systems, or the extent to which such reviews are performed. Without
such reviews, any weaknesses such as existence of ghost workers, especially in sectors such as
education and health, that have very large public sector workforces, may not be highlighted.

119. The net result of these gaps and the uncertainty about monitoring of personnel changes is
an aggregate PEFA rating for the payroll internal control component of NR.

### PEFA Score for PI 18: Effectiveness of payroll controls

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Degree of integration and reconciliation between personnel records and payroll data.</td>
<td>D</td>
</tr>
<tr>
<td>(2) Timeliness of changes to personnel records and the payroll.</td>
<td>NR</td>
</tr>
<tr>
<td>(3) Internal controls of changes to personnel records and the payroll.</td>
<td>C</td>
</tr>
<tr>
<td>(4) Existence of payroll audits to identify control weaknesses and/or ghost workers.</td>
<td>D</td>
</tr>
<tr>
<td><strong>Aggregate Rating</strong></td>
<td><strong>NR</strong></td>
</tr>
</tbody>
</table>

*Non-Salary Expenditure Controls*

120. **The internal control system over non-salary expenditures has been improved in a
number of ways.** First, the effectiveness of expenditure commitment controls has improved with
the introduction of the Treasury system. A computerized commitment system is in place and all
TSA organisations maintain records of their commitments to ensure that they stay within their
budgetary limits for the year. Second, MOF has recently prepared internal control procedures
relating to the Treasury operations. Written procedures on budgetary controls, treasury controls,
accounting and reporting controls, procurement controls, and human resource controls are said to
be in place, but they were not readily available for validation for this report. These controls are
being implemented across the government ministries. Finally, there is a mechanism of
monitoring the results of the inspections by a special monitoring unit of the CRU. When
violations or infringements are revealed in inspections, recommendations are sent to the agencies
concerned and they are required, within one month, to report on the actions taken to resolve the
issues.

121. **Where actions taken by the agencies are deemed unsatisfactory the CRU conducts a
follow up audit, sometimes by way of an on-site visit, to verify actions taken.** However, the
large number of budget organizations cannot be adequately covered by the CRU. Its staffing
complement is only 789 to cover an audit universe of over 30,000 budget organizations. Only
about 30% of budget organizations can be covered during by programmed inspections, and this constitutes a major constraint to meeting their stated audit cycle target of 3 years. However, the internal control division within the Treasury supplements the work of the CRU by carrying out ex-ante and, sometimes, ex-post controls, ensuring that budget organizations comply with procedures established for expenditure controls. The overall rating for non-payroll controls is B.
PEFA Score for PI 20: Effectiveness of internal controls for non-salary Expenditure

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Effectiveness of expenditure commitment controls.</td>
<td>B</td>
</tr>
<tr>
<td>(2) Comprehensiveness, relevance and understanding of other internal control</td>
<td>B</td>
</tr>
<tr>
<td>rules/procedures.</td>
<td></td>
</tr>
<tr>
<td>(3) Degree of compliance with rules for processing and recording transactions.</td>
<td>B</td>
</tr>
</tbody>
</table>

Aggregate Rating: B

Recommendations

- MOF should develop and implement a new internal control strategy that takes into account the Treasury reforms and the associated GFMIS. The strategy should progressively modernize the internal control environment within government through modified internal control processes and new institutional arrangements, including establishment of internal audit units across government.
- The role of the Internal Control Division in the Treasury should be adjusted to permit the creation of an Internal Control and Audit Policy Unit49 for the development and implementation of policies on internal controls and internal auditing.
- MOF should strengthen its payroll controls on a priority basis.

B. Internal Audit

122. There are no internal audit units in line ministries. Instead a fairly decentralized Control and Revision Unit (CRU) performs the role of internal audit. Although there are international standards for internal audit these are not applied by CRU. The Institute of Internal Auditors (IIA) has defined internal audit as “an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”50. The IIA also has a set of internal audit standards for use by all internal auditors, whether in the public or private sector. A series of professional development activities are also offered so that aspiring auditors can obtain the necessary training to get their Certified Internal Auditor designation.

Recent Progress

123. The CRU inspection function in Government performs some of the functions of internal auditors. It performs compliance inspections on budget entities according to a multi-year inspection plan. There is a well-developed system whereby the CRU inspectors detect violations, make recommendations for corrective actions and, where necessary, levy penalties against the entity. The Treasury CRU function has had its responsibilities extended by including a responsibility of internal auditors in their role of making recommendations for improvements where systemic errors are detected. In addition the MOF issued Order # 86 of June 7, 2010 on further measures to strengthen controls and budget discipline. However, these measures do not make the CRU into an internal audit unit. Other decisions are necessary for the government to undertake to support the creation of internal audit functions across government. Box E refers.

49 Also known in the EU PIFC terminology as a Harmonization Unit
50 See www.theiia.org for the definition.
Box E: Consequential Internal Audit Policy Decisions

- assign to the Minister of Finance all policy and administrative responsibilities for the operation and direction of internal audit implementation and operation,
- develop audit policies that are compliant with international audit standards
- develop an implementation plan for internal audit across government and ensure its effective implementation
- develop a strategy for the conversion of CRU inspectors to internal auditors
- create a modern, standards-based internal audit policy and operations unit within the MOF (this is called Central Harmonization Unit in the EU) to develop audit policies, monitor compliance across government and conduct audits for small organizations without their own audit capacity
- establish minimum competency requirements for internal auditors
- develop and implement a training program for the further development of auditors

124. In the past year a Bank-financed project was implemented by the MOF to develop a strategy and a roadmap for the introduction of modern internal audit. This work was completed and submitted to the MOF in May 2009. The study results consisted of an internal control and audit framework, the required laws, regulations and decrees necessary to implement the initiative, a manual of internal audit policies and practices, a roadmap for implementation and training seminars for MOF staff on internal audit principles and practices.

125. The government has not announced any decisions regarding the establishment of modern internal audit units across government. This is an important initiative for the medium term development of the function. At present, there are no internal audit units in government and the CRU/Treasury unit only partially fulfills internal audit’s functions. For example, they do not employ IIA international standards in their audit planning, execution, reporting and quality assurance processes relating to internal audits. Nor has the government endorsed these standards as being appropriate for use by the government of Uzbekistan.

Analysis

126. The MOF Order # 183 dated December 31, 2010 on provision on auditors of the CRU is an important step towards establishing institutional structure for internal audit. However, a clear decision by the government on the implementation of internal audit and the future role of the CRU function would point to a clearer reform direction. Even though implementation will be a medium-term project, the basic structures could be established now in Law and regulation. The present absence of any standards for modern internal audit means that the PEFA assessment criteria for internal audit have not been met.

127. The existing CRU function could be converted over time to become a modern internal audit function. This would require a change to a COSO51-like internal control framework, which would have a significant impact on the operations of the future internal auditors. The Control and Revision Unit of the Ministry of Finance focuses on top-down controls over compliance, which does nothing to support managers in budgetary institutions to establish, maintain and be held accountable for the internal control environment. However, it has the staff with the educational fundamentals and experience in compliance and attest auditing that could be converted over time to perform a modern internal audit function.

51 Committee of Sponsoring Organizations of the Treadway Commission
128. **The CRU continues to innovate.** It recently established a national system of hotlines for the citizens to call to advise the CRU of any instances of errors, fraud or illegal actions.\(^{52}\) The CRU has a service standard of 15 days to review the complaint and to take action. The establishment of these hotlines has been reported in the national and local media.\(^{53}\) This reinforces its focus on compliance and prevention of illegality.

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**Box F: The Control and Revision Unit of the Ministry of Finance**

**Introduction**

The MOF Control and Revision Unit currently has 789 staff, which is a reduction from the 860 staff members according to the 2004 CFMA. There are 68 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.

**Scope Of Work**

- Ex-post audit (inspection) 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, after every 2-3 years;
- 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;
- Ad hoc inspections at the request of law enforcement agencies or parliament, or when complaints are received in the Ministry of Finance about possible misuse of public funds by a budget entity.

**Capacity issues**

- The majority of CRU inspectors have a degree in finance or economics. Management intends to recruit graduates who have experience in the budgetary systems of Uzbekistan.
- CRU holds annual training courses that cover legislative changes and inspection methodology. Their staff also participated in training programs financed by an IDF grant from the World Bank, including a study tour to Slovakia in 2009. The training workshops and study tour provided CRU staff with opportunity to learn modern audit methodologies and audit planning.

*Source: CRU*

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129. **The scope of CRU’s 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 F above). While this function is important, the medium to long-term goal should be to develop a modern decentralized internal audit function that is supportive of the treasury reforms. 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.\(^{54}\) 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.

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\(^{52}\) Established under Minister of Finance Order # 62/12 April 2010

\(^{53}\) *Narodnoe Slovo*, May 19, 2010.

\(^{54}\) In fact, there is a financial incentive NOT to identify the systemic issues and hence reduce the incidence of control violations. See the next paragraph.
130. **Salaries and incentives within CRU are a perverse incentive to improvements in internal controls.** 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 the MOF Special Development Fund, of which 25 percent is used for salary enhancements to MOF staff and 75 percent for capital projects within the Ministry. While base salaries for CRU staff are in line with other public servants, CRU staff can earn up to two times their regular salary based on results and overall performance. This provides a positive incentive for CRU inspectors not to force remedial actions and thereby maintain or expand the levels of fines and other financial deterrents so as to maximize their bonus income. In the medium to long term, incentives for CRU staff should be based on the primary and broader objectives of improving systems of public sector financial management rather than the maximization of receipts from inspections.

131. **CRU’s decentralized structure and its trained personnel provide a sound foundation on which to build a modern decentralized system of internal audit units across government.** The Treasury “internal audit” unit is essentially a CRU unit, with an additional responsibility assigned to the regional Treasury CRUs to assess systems deficiencies and report on them to the main treasury department. This would require as a prerequisite the adoption of a COSO-like model for internal control and audit before this could be pursued.

132. **Given the absence of internal audit in the Government, the CRU function was assessed against the three audit criteria.**

- On the issue of coverage, it was noted that while the CRU was not adequately resourced to provide regular and systematic coverage of all budget organizations, it did perform a risk-based assessment to select its entities for audit. However, there is little or no focus on systemic issues.
- The distribution of reports is closely held between the CRU, the entity audited and its responsible executive. As a result, there is no opportunity for MOF, the Chamber of Accounts or other entities to learn about issue of importance that are reported in the CRU inspection, and how the underlying problems were addressed. Management response is reported as strong. This reflects the mandatory nature of action by managers for remediating any problems identified in the inspection.

The overall score for this PEFA rating was assessed as D+.

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55 The team was advised that in 2009, CRU activities resulted in the return of 32 Billion UZS to the budget, recovered as a result of unauthorized activities.

**Recommendations**

- The government should establish an appropriate legal and institutional framework for modern internal audit with authorities, responsibilities, and scope established by Law in a manner consistent with international standards and containing a management-approved Internal Audit Charter.
- The Ministry of Finance’s approved *Public Financial Management Strategy 2007-2018* should be expanded to include a phased approach to internal audit reforms which build audit capacity in tandem with the on-going treasury reforms.
- The government should include in its *Strategic Public Financial Management Strategic Plan 2007-2018* a strategy to progressively convert the CRU into a modern internal audit function in all government ministries and other key entities within Government, or separately prepare and adopt an internal audit strategy.
- The current incentive structure for CRU should be eliminated as it is changed to a modern internal audit function.

**VI. EXTERNAL OVERSIGHT**

133.  A high quality external audit is an essential requirement for creating transparency in the use of public funds. Key elements defining the quality of external audit include the scope and coverage of the audit and the adoption of appropriate auditing standards, including the independence of the external audit institution. 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 quality of public expenditure and the management of public assets and liabilities. The legislature has a key role in exercising scrutiny over the execution of the budget that it approved.

A. External Audit

134.  Decree UP-3093 issued in June 2002 established the Chamber of Accounts as the independent highest financial supervisory body, impartial and objective in its judgments. The decree also defines its tasks and powers. The President and the Cabinet of Ministers have approved additional sub-legislation to strengthen the functions and powers of the COA, of which the more recent Presidential Decree PF-3592/April 2005 and the Cabinet of Ministers Resolution 460/ October 2006 are the most significant. It states that the COA is accountable to the President
and the Oliy Majlis of the Republic of Uzbekistan and therefore the annual report on the Chamber’s activities is presented to both.

**Recent Progress**

135. **The 2004 CFAA recommended that the government should establish a firm legal basis for the Chamber for Accounts’ activities.** The government responded in its amendments to the Budget Systems Law by requiring the Chamber of Accounts to report to the Budget and Finance committee of the Oliy Majlis. The COA now also reviews the annual accounts of the government before accounts are submitted to the Oliy Majlis, identifying major deviations of actual figures from budget appropriations and examining the government’s explanation of the reasons for such deviations.  

136. **As well, the COA has been establishing closer links with other external auditors of government and Parliament.** It has been in discussions with INTOSAI and its regional ASOSAI sub-group and expects to become a member during 2010. It is also forging closer linkages with Parliament in order to meet their audit requirements now that the parliament is an identified “client” of the function. External auditors are now receiving international standards training in attest and compliance auditing techniques and additional professional development will emerge as a result of the linkages with ASOSAI institutions.

**Analysis**

137. **The mandate of the Chamber of Accounts is quite different from that found in many other countries.** The main tasks assigned under Decree UP-3592 include a number of specific items of a macroeconomic nature that would normally be performed by the Central Bank of Uzbekistan or by the MOF. Box G summarizes these duties.

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57 A more ambitious 2005 EU-TACIS recommendation that the government pass the necessary legislation to: establish the Chamber of Accounts as the Supreme Audit Institution of the Republic of Uzbekistan with the necessary legislation for its independence laid down in the Constitution; provide adequate legal protection against any interference, ensure its complete independence; and provide for an audit mandate reflected in consequential amendments to the Audit Law. The team was advised that a draft law was prepared, but has not been passed.
138. The first eight of these tasks are unusual in their specific focus on the management of the economy and its key levers of control. The requirements to fulfill these tasks would require a well-staffed group of macroeconomists with skills in macroeconomics and international finance. The team was unable to access any of the annual audit reports of the Chamber of Accounts, and is therefore unable to assess the extent to which the Chamber of Accounts has been discharging effectively these requirements. In addition to the risk that some of these reviews may not have been effectively performed, the eight tasks are a responsibility of the Executive. By involving the External Auditor in the review of internal government macro-fiscal operations, the independence of the audit office has been compromised.

139. The government should review these non-traditional external auditor responsibilities to bring them more into compliance with contemporary international practice. The traditional external auditor responsibilities include: the audit of the government’s summary financial statements; the conduct of attest and compliance audits on significant budget organizations and the development and conduct of performance (or value-for-money) audits of government operations. The government should consider amending Decree UP-3592 to establish the key responsibilities of the Chamber of Accounts as those endorsed by international external auditing standards (ISSAIs) for external auditors worldwide.

140. The current staffing structures provides for 20 permanent staff. These include the Chairman, Deputy-chairman and Inspectors. The President determines the organizational structure, staff and the quantitative composition of the COA. He also has the power to dismiss staff. Decree PF-3592 broadly identifies the skills and competencies of the staff of the COA. In practice staff is selected with managerial experience from organizations such as the MOF, the CRU, Central and Commercial Banks, Tax and Customs Services, Anti-monopoly Agency and private auditing firms. All appointed employees are also required to have substantive experience

58 The macroeconomic tasks identified above could be done as one-time value-for-money audits, but at a high cost for the retention of independent experts to participate on the audit team.
59 International Standards of Supreme Audit Institutions

<table>
<thead>
<tr>
<th>Box G: Main Tasks of the Chamber of Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Conduct research on the process of formation of macroeconomic parameters of the draft State Budget</td>
</tr>
<tr>
<td>o Critically evaluate compliance with government priorities of market reform and liberalization of the economy</td>
</tr>
<tr>
<td>2. Conduct factor analysis of the formation and execution of the revenue budget</td>
</tr>
<tr>
<td>• Evaluate actual vs. forecast revenues, with particular attention to the spheres of economic activity.</td>
</tr>
<tr>
<td>3. Evaluate Monetary and credit policies, measures to strengthen the national currency, optimize money supply and monetary aggregates and curtailment of out-of-banking-sector turnover.</td>
</tr>
<tr>
<td>4. Evaluate the state of foreign trade turnover and use of balance of payments.</td>
</tr>
<tr>
<td>5. Monitor execution of forecast of exports of goods and ensure optimization of imports</td>
</tr>
<tr>
<td>6. Conduct research on supply and demand of foreign currency, the dynamics of the exchange rate and conduct of control over conversions of the national currency.</td>
</tr>
<tr>
<td>7. Evaluate the volumes and purposefulness of external borrowings, the use of foreign loans and grants, and loan servicing.</td>
</tr>
<tr>
<td>8. Implement control over the State gold currency reserves.</td>
</tr>
<tr>
<td>9. Monitor the financial state of the agricultural entities and related EBFs for water and agricultural development</td>
</tr>
<tr>
<td>10. Analyze and control local budget formulation and implementation</td>
</tr>
<tr>
<td>11. Ensure control over execution of Republican Budget and expenditures in Republican, State and local levels.</td>
</tr>
<tr>
<td>12. Control all aspects of financial operations of EBFs</td>
</tr>
</tbody>
</table>

Source: Chamber of Accounts
in the areas of financial and internal control as well as auditing. A higher diploma in Economics and Law is a minimum academic requirement; the curriculum for training of experts in Economics and Law includes mandatory courses in accounting and auditing.

141. The number of auditors staffed by the COA is insufficient to provide good coverage of the audit entity as required by law. The COA partially compensates for this by using external specialists to assist in their audits. However, a number of these are drawn from the government itself, potentially affecting adversely their judgments. This affects the PEFA assessment of the audit scope in PI-26 as well as the coverage on the legislature’s oversight in PI–27, discussed in the next section.

142. The COA independence is potentially compromised by its use of seconded government specialists to assist in its audits. Due to staffing constraint staffs from ministries are often seconded to the COA at no cost to support them in conducting special *ad hoc* inspections. This has the potential for these staff to compromise the independence of the COA’s audit conclusions because of the influence of staff from the government who may be predisposed to favor the government positions.

143. The nature and scope of the audit work is conducted in concurrence with guidelines that have been prepared by the COA. The team was advised by the Chairman that these guidelines take into account the broad principles of the Lima Declaration\(^{60}\) as well as the requirements of National Auditing Standards of the Republic of Uzbekistan. In addition, much reliance is placed on the prior work experience and skills of the staff that are appointed in the COA in order to conduct their work. However the COA does not conduct its work strictly in terms of these standards. Its audit planning does not fully reflect a risk-based approach. There appears to be much scope for the audit methodology to be improved in line with international standards. While the major part of the COA’s work focuses on financial compliance testing, some elements of performance auditing are applied when the auditors perform *ad hoc* inspections, but this falls short of a full technical performance audit.

144. The COA prepares a work plan twice a year. It has the responsibility to audit any organization that receives budgetary allocations and benefits or uses or manages state property. The audit objective is to visit all ministries and agencies on an approximate three-year cycle. Consequently the annual audit coverage (percentage of budget funds subject to COA audit) is relatively low and its PEFA sub-indicator is affected negatively.\(^{61}\) The COA should consider establishing minimum annual audit coverage of entities by some factor (such as funds at risk, absolute budget percentage audited annually, etc.) set out in law or decree. This would then become a reporting reference point in the auditor’s annual audit report. It would also require the allocation of additional audit resources, especially staff.

145. The COA conducts it audits in ministries and agencies with a focus on the most critical and fundamental elements of the government’s budget. Their audits focus on financial compliance testing of the internal control framework and follow-ups on earlier findings arising from previous audits. Findings of material irregularities often result in strong sanctions and such cases may be handed over to law enforcement bodies. At the conclusion of the audit, a report on the findings and recommendations is prepared. This report is discussed with the management of the immediate higher authority of the audited organization. Management would

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\(^{60}\) *Lima Declaration of Guidelines on Auditing Precepts*, October 1977, IX INCOSAI.

\(^{61}\) The team estimated that the COA is far from meeting even its three-year target for audits, given their present levels of staffing.
then consider the proposed recommendations and, together with the COA team, agree on the actions to be taken to ensure that future violations are minimized.

146. The report on such financial compliance testing is submitted to the highest regulatory authority of the organization audited and a special note is submitted to the Presidential Office. Such report can also be made available to the Oliy Majlis and the Cabinet of Ministers. The Cabinet of Ministers may, from time to time, issue regulations to eliminate recurring deficiencies and to strengthen the internal control framework. The COA may also organize a workshop for ministries and other agencies to alert them on the critical control weaknesses that they had identified during the course of their work.

147. Feedback on findings and recommendations are required within one month after the submission of a report by COA to the organization audited. Information is required on measures that will be implemented to eliminate weaknesses. The COA reviews the comments from the budget organization audited and, if necessary, a follow up inspection is arranged to confirm the adequacy of the measures adopted. If the audited entity fails to provide timely feedback or to implement the proposed changes, an administrative penalty can be levied against the head of the audited organization. However, the COA informed the team that it prefers to follow an unbiased approach and would rather engage in discussion with the management of such organization to try and resolve the issue.

148. The Cabinet of Ministers sends the consolidated government annual financial statements (report on Execution of the State Budget) to the COA by April 5 for the purposes of external audit and evaluation. The COA submits to the Cabinet of Ministers its conclusions to the report by no later than May 10th of that year. The latter is required to submit to the Oliy Majlis the consolidated government annual financial statements along with the relevant conclusion of the COA no later than May 15th. The Oliy Majlis is then required to review and approve these in three stages by June 15th as follows:

- The Committee on Budget and Economic Reforms considers these reports after a lengthy discussion on areas of control weaknesses that had been identified in the report of the COA. These deliberations are conducted in consultation with representatives from ministries and agencies that are indicated in the report.
- The reports are then discussed and considered by factions (groups of parties) in the Oliy Majlis.
- It is then discussed and considered by all deputies (representatives) of the Oliy Majlis.

149. The parliamentary proceedings and the approval of the reports are covered by the mass media that are invited to attend together with other interested parties. However, copies of the actual consolidated government annual financial statements along with the relevant conclusion of the COA are not publically available in either paper or electronic format. Despite this interest, there appeared to be no support from the parliamentarians for a significant increase in the transparency of these government accountability documents to the broader public. There was the general feeling that the media conduit for the government’s reports was sufficient. The team does not share this viewpoint.

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62 In accordance with Article 39 of the Budget System Law, it includes information about key findings from their work performed as well as recommendations for the improvements of internal controls where deficiencies exist.

64 See, for example, Uzbek Chamber of Accounts Gives Report to Parliament, Trend, 24 April, 2010.
150. **Copies of the consolidated government annual financial statements along with the relevant conclusion of the COA are not publically available in either paper or electronic format.** Subsequent to approval of the budget report or the budget execution report by the Oliy Majlis, the reports are forwarded to the Senate that follows a similar procedure of three-stage review. Approval by the senate is an indication that the work of the COA had been completed. The final step is the preparation of a consolidated note to the President’s Office to confirm that the process had been concluded.

151. **The Chamber of Accounts currently does not act as the external auditor for Bank-financed projects.** This is unlike in some countries that have mature external audit functions, using international standards in their work. Given its present legal and institutional structure, mandate, scope and the information provided as part of this assessment, the quality of external audits being conducted by the Chamber of Accounts may not be in full compliance with international audit standards. As such, the COA may not have capacity to audit Bank financed projects. Should the Chamber of Accounts implement the set of recommendations contained in this report this status could be revisited.

152. **Since 2004 the COA had been participating in INTOSAI events and workshops and in some cases as presenters at these events.** They plan to become a member of the Asian Organization of Supreme Audit Institutions (ASOSAI) during 2010. In addition, since 2004, every year two staff members had been attending training on modern training techniques, sponsored by the Japan International Cooperation Agency (JICA). In November 2009, the COA signed a bilateral Agreement on Cooperation with the Chamber of Accounts of the Russian Federation envisaging mutual exchange of experience and information.

**PEFA Score for PI 26: Scope, nature and follow-up of external audit**

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Scope/nature of audit performed (incl. adherence to auditing standards).</td>
<td>D</td>
</tr>
<tr>
<td>(2) Timeliness of submission of audit reports to legislature.</td>
<td>A</td>
</tr>
<tr>
<td>(3) Evidence of follow up on audit recommendations.</td>
<td>B</td>
</tr>
<tr>
<td><strong>Aggregate Rating</strong></td>
<td><strong>D+</strong></td>
</tr>
</tbody>
</table>

**Recommendations**

- The government should consider amending Decree UP-3592 to establish the key responsibilities of the Chamber of Accounts as those endorsed by international external auditing standards (INTOSAI) for external auditors worldwide.
- The government should consider proceeding with the submission of a draft Law on the Chamber of Accounts to Parliament for consideration and approval. This would *inter alia*, enhance the independence of the COA and would make it accountable to parliament rather than to the President.\(^65\).
- The COA should consider establishing minimum annual audit coverage of entities by some factor (such as funds at risk, absolute budget percentage audited annually, etc.) based on annual work plan.

\(^65\) During the Dissemination Workshop it was reported that the draft law has been submitted to the legislative chamber for consideration
To avoid compromising the independence of the Office, the COA should cease performing *ex ante* reviews of key budget and related documents that are the exclusive prerogative of the Executive.

The COA should consider developing a program of collaboration with other well established SAIs that may include peer review of its activities and other long-term capacity development activities, either through twinning arrangements or exchange programs.

The COA should create a strategic audit development plan that includes the full adoption of international auditing standards and expanding the scope of audits to cover a larger proportion of the entities and expenditure each year.

B. Parliamentary Oversight

Recent Progress

153. **Parliamentary oversight of the government is in part accomplished through its review and approval of the proposed annual budget.** This is also complemented by a review of the budget execution report that is tabled by the Minister of Finance at the same time as the New Year budget proposal. In some countries, parliamentary controls over the government’s budget have been a cornerstone of democratic practices for hundreds of years. For others, it is still an evolving concept.

154. **There have been improvements to parliamentary oversight.** The amendments to the Budget Systems law established a direct reporting relationship between the COA and parliament. Parliamentarians appear to support these changes and use the external auditor to assist them in their oversight activities. Other related recommendations that were made have addressed the issues of an appropriations structure for the budget proposals to parliament, timeliness of preparation of budgets and financial statements, the quality, structure or content of the information presented in these statements or in the addition of information relating to non-financial performance information have been addressed in earlier sections of this report.

Analysis

155. **Discussions with the Chairpersons of the Budget and Economic Reform Committees of both the Oliy Majlis and the Senate** indicated that there was a strong interest in the annual budget proposals of the government and in their budget execution reports. Both Houses had a large number of committee members, who were assisted by external experts to analyze the documents submitted to them, to develop questions to pose to the government and the bureaucracy witnesses in specific hearings to review the budget proposal and the budget execution report. The review processes in both Houses are well established and similar in nature.

156. **For the budget proposal both Houses reviewed all of the extensive budget documents prepared by the government.** These included the macro-economic framework and the budget parameters, the government’s proposed spending priorities and the draft budget in aggregate terms. These committees probed and challenged the government’s assumptions and

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66 One such entity that provides these services is SIGMA.
67 There was an EU TACIS project in 2002 to support to the modernization of the Oliy Majlis.
68 There were 17 members in both the Oliy Majlis and the Senate committees.
69 Given the recent decision to extend the Treasury to the extra-budgetary funds, the Sate Targeted Funds and all development accounts, the budget will now have a comprehensive presentation of all aspects of the government budget sector.
decisions regarding all aspects of the macro-fiscal plan, the forecast revenues and their sources as well as the planned expenditures. Expert groups, drawn from specialists in the government ministries, NGOs and other experts such as academics are created to assist the committee members in their deliberations.

157. **The budget is considered by a number of committees in parallel each one dealing with aspects of the budget that fall into their specific subject area.** Each House also convened with all of its members to consider and approve their recommendations for the government on the draft budget. The team was advised that the government generally implemented their recommendations. Both Houses are assisted by the Chamber of Accounts in the follow up and monitoring of the government’s implementation of all of their recommendations. Both the Oliy Majlis and the Senate committee chairs agreed that they had sufficient time and resources to review the budget and complete their recommendations.

158. **The use of expert advisors from within government represents a potential conflict of interest.** Because the Parliament is supreme, it should benefit from sound advice that is independent of the government ministries whose budgets and audit results are subject to oversight control by Parliament. In many countries, a small, permanent staffs of experts are recruited as parliamentary employees who work full time in support of their budget committee members’ research and analysis needs. The parliament should consider a phased move to more independent advice as it gains experience in its current mode of operation.

### Table 3: Timelines for Consideration of Budget-Related Reports

<table>
<thead>
<tr>
<th>Report</th>
<th>Oliy Majlis</th>
<th>Senate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Receive by</td>
<td>Report by</td>
</tr>
<tr>
<td>Draft State Budget</td>
<td>15 October</td>
<td>15 November</td>
</tr>
<tr>
<td>Budget Execution Report</td>
<td>15 May</td>
<td>15 May</td>
</tr>
<tr>
<td></td>
<td>31 August</td>
<td>31 August</td>
</tr>
</tbody>
</table>

**Source:** MOF, Oliy Majlis, Senate

159. **Established internal review procedures exist for both Houses of Parliament and are respected.** The Budget System Law has set the deadline for the Oliy Majlis to receive the budget no later than October 15th and to report by November 15th. The report is then sent to the Senate, where it completes its review by December 15th. Both committees invite all members of the media to attend these hearings, and the discussions are widely reported in the media. The rules governing the preparation of in-year changes to the budget are clearly set out in Article 34 of the Law on Budget System (#130/2007). It was concluded that the Parliamentary budget review process was clear and transparent.

160. **Both the Oliy Majlis and the Senate budget committees consider the budget from an economic policy and management perspective.** They are particularly interested in the budget’s forecasts for growth in the economy, the creation of jobs and sector-specific proposed spending

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70 Individual ministry resource allocations are made by MOF following passage of the annual budget law by both Houses and the signature of the President.
71 For example, the Senate had 6 committees: Legislation and Courts; Defense and security; Foreign Affairs; Science, Culture and Sports; Agriculture, Water and Economy; and Budget and economic Reform. The Oliy Majlis had 11 such committees.
and the efficient use of the financial resources granted to the government by parliament. The Senate committee appeared to be more focused on the macroeconomic framework and its economic development impacts. In addition, all of the legislature’s hearings on audit reports are held in public with the responsible government officials present as appropriate to give testimony to the committee. These proceedings are reported in the press. The reports of the committee are tabled and discussed in the Oliy Malis and may involve the responsible minister.

161. **The Oliy Majlis committee gives priority attention to the financial management implications of the budget.** The consideration of the budget execution report and the Auditor’s report occur simultaneously. As prescribed by law, a fixed schedule is laid out for their consideration of the government budget execution report for the year. The Chairman of the Oliy Majlis strongly supported the proposal\(^{72}\) to move to an appropriation-based system of budgeting, stating that it would provide them with more detail on the planned spending by individual ministries.\(^{73}\)

162. **Both Houses actively investigate COA-identified problems.** These may be problems identified by the COA in their annual budget law review or in their report on audits from their annual audit plan. They strike special investigative committees, consisting of members of the committee, the auditors from the Chamber of Accounts and outside experts, who then visit selected oblasts and rayons where the auditor has found significant problems and made specific recommendations.\(^{74}\) There is follow up on all such visits to ensure that the auditor recommendations are implemented. The team believes that these committees’ analyses of the final accounts of the government for the year are thorough.\(^{75}\) The committees may request by formal letter that the Chamber of Accounts schedule a particular audit of interest to the committee.

163. **Parliamentarians did not express any concern over time allotted for their review of COA reports.** Both Houses indicated that they generally had sufficient time to complete their reviews, that the resources to which they had access were sufficient, that they were able to respond in the timeframes identified by law and that the rules for in-year budget amendments were clear and respected by the government. However, the limited resources available for the audits adversely affect the scope of the legislature’s oversight and the scope of their recommendations and follow up activities, both of which were rated B. As a result, the PEFA indicators for reviews of the two key accountability documents were rated as B+ and B respectively.

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\(^{72}\) This proposal is currently under consideration within the government.

\(^{73}\) This issue was discussed in detail in the Chapter on Budgeting.

\(^{74}\) This process undoubtedly encourages compliance with whatever the auditor wants to have improved.

\(^{75}\) The Law requires the committee to complete its review of the auditor’s report by the end of the following fiscal year.
PEFA Score for PI 27: Legislative scrutiny of the annual budget law

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Scope of the legislature’s scrutiny</td>
<td>B</td>
</tr>
<tr>
<td>(2) Extent to which the legislature’s procedures are well-established and respected</td>
<td>A</td>
</tr>
<tr>
<td>(3) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals for macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages).</td>
<td>B</td>
</tr>
<tr>
<td>(4) Rules for in-year amendments to the budget without ex ante approval by the legislature</td>
<td>A</td>
</tr>
</tbody>
</table>

Aggregate Rating B+

PEFA Score for PI 28: Legislative scrutiny of external audit report

<table>
<thead>
<tr>
<th>Sub Indicator</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Timeliness of examination of audit reports by the legislature in the last three years</td>
<td>C</td>
</tr>
<tr>
<td>(2) Timelines and extent of hearings on key findings undertaken by the legislature</td>
<td>A</td>
</tr>
<tr>
<td>(3) Issuance of recommended actions by the legislature and implementation by the executive</td>
<td>B</td>
</tr>
</tbody>
</table>

Aggregate Rating C+

Recommendations

- The Parliament should state its support, at an appropriate time, for the concept of appropriations-based budgeting and request the government to implement the proposal.
- The Parliament should consider replacing the use of the financial specialist experts from within the government who presently serve on its advisory panels for government budget reports and the COA audit report with a small unit of experts in public financial management and economics to work full time in supporting their respective budget committees in their analysis and review of the material submitted to their committees by the government.

VII. FIDUCIARY RISK IN BANK-FUNDED PROJECTS

164. This section reviews the financial management and public procurement arrangements in respect of World Bank (the Bank) requirements for IBRD/IDA-financed projects. Specifically, it:

- assesses the general quality of the financial management and public procurement arrangements for the Bank-financed portfolio;
- highlights the key issues that affect the overall quality of financial management and public procurement in the Bank portfolio;
- recommends measures to improve financial management and public procurement arrangements in future Bank operations.
The Bank’s Uzbekistan portfolio currently consists of nine operations. These comprise two IBRD Loans and seven IDA Credits. One loan, due to close in June 2010, is to be extended for a limited period. Subject to the outcome of on-going discussions between the Bank and the Government four new operations may enter the portfolio in FY 2011-2012.

A. Financial Management Arrangements

Project Fiduciary Institutional Arrangements

Standalone project implementing units (PIUs) have managed the majority of the World Bank-financed projects in Uzbekistan. The one exception is the Basic Education Project (BEP) that has been implemented by the Ministry of Public Education (MOPE) with consultants’ support. While the PIU mitigates the risks associated with weaknesses in government systems, it does little to develop long-term public sector financial management capacity in government ministries and agencies. This remains a challenge for the Bank and the management of the projects.

Availability of skilled staff remains a challenge. The core fiduciary staff in most PIUs includes Financial Manager, an accountant and a procurement officer. MOPE has also hired Financial and Procurement Consultants who have specific responsibility for BEP project accounting & reporting and procurement respectively. Overall, recruiting and maintaining of the skilled accounting and public procurement professionals for projects is difficult, due to relatively low remuneration. The Bank’s Country Office has discussed the remuneration issue with the government, as part of the overall portfolio review, but no agreement was reached. PIUs often hire staff with an economics, bookkeeping or engineering background; they then undergo training in project financial and procurement management. There are a small number of experienced project accountants and procurement specialists that tend to rotate amongst the PIUs.

The PIUs install standalone project financial management systems that are not integrated into the government accounting, reporting and audit systems. They maintain separate bookkeeping systems and project financial statements are audited annually by private audit firms. These firms are subject to periodic reviews by Bank staff to determine their eligibility to audit Bank-financed projects.

Financial management arrangements and procurement capacity for new projects are assessed against the Bank’s fiduciary requirements. The practice is to have acceptable financial management and procurement arrangements (i.e. project accounting, financial reporting, internal control, auditing, procurement planning, procurement systems and arrangements, risks and mitigation and financial management and procurement 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 Implementation Supervision

The Bank provides implementation supervision support for its financed projects throughout the project life. This is done 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.

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. There has been only one qualified project audit report in 2008. This occurred when the Treasury failed to provide information to the auditors on the level of counterpart funding provided to the project in the form of in-kind contributions.

172. Compliance with audit covenants was low. Timeliness remains an issue. Out of nine projects with audit reports due by June 30, 2009, only five had submitted their audit reports on time.

173. There is also a problem with the level and timeliness of providing counterpart funding for some projects. One project experienced insufficient co-financing and permanent delays in the remitting of the government’s share. These delays can cause large penalties levied by, for example, social insurance (36% in this one case). This occurred despite the funds being approved by the COM to cover the social payments. Additional attention by MOF is necessary to avoid such penalties.

174. Other financial management issues were identified during Bank supervision and audits. They included:

- **Budgeting:** Budgeting figures mainly are limited to procurement plans and counterpart funds. However, budgeted figures are not consolidated to show the overall position of the project.
- **Internal control:** Drawbacks in internal control lead to inadequate executing of accounting for project transactions and reporting on project activities, such as misclassification of expenditures under proper categories; confusion in spending from World Bank accounts and from other development partner funds, discrepancies between accounting registers and Statements of Expenses, etc.
- **Internal Audit:** 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.
- **Non-compliance with Bank requirements:** On occasion Bank funds have been confused with funds of other development partners. There have also been instances of inadequate accounting for counterpart resources. Due to a lack of counterpart funds, the Bank funds have often been used to pre-finance expenditures that should have been paid out of counterpart funds thus giving rise to ineligible expenditures.
- **External Audit:** The Bank still does not rely on audit reports of Chamber of Accounts. 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.

175. 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. The last audit firm review was conducted in November 2009. It has revealed a general deterioration of the quality of the audit work by the engaged firms. While in the past there were two local firms eligible to conduct project audit and one fully eligible international audit firm, based on the results of the most recent assessment, only one local firm remained eligible to conduct project audits and one international audit firm was qualified as fully eligible.
### Table 4: World Bank Uzbekistan Project Risk Assessment

<table>
<thead>
<tr>
<th>Project</th>
<th>Title</th>
<th>Fiduciary Risk Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>P051370</td>
<td>Health 2 Project</td>
<td>Substantial</td>
</tr>
<tr>
<td>P094042</td>
<td>BASIC EDUCATION, Phase I</td>
<td>Substantial</td>
</tr>
<tr>
<td>P101583</td>
<td>Health &amp; Education ME&amp; Capacity Building IDF Grant</td>
<td>TBD</td>
</tr>
<tr>
<td>P107845</td>
<td>Second Basic Education</td>
<td>N/A</td>
</tr>
<tr>
<td>P009127</td>
<td>Drainage, Irrigation &amp; Wetlands Improvement Project - Phase 1</td>
<td>Substantial</td>
</tr>
<tr>
<td>P049621</td>
<td>Bukhara &amp; Samarkand Water Supply Project</td>
<td>High</td>
</tr>
<tr>
<td>P109126</td>
<td>Rural Enterprise Support Project Phase II</td>
<td>Substantial</td>
</tr>
<tr>
<td>P110538</td>
<td>Ferghana Valley Water Resources Management Phase-I Project</td>
<td>N/A</td>
</tr>
<tr>
<td>P112719</td>
<td>Uzbekistan Bukhara and Samarkand Sewerage Project</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*Source: World Bank*

### Towards Mainstreaming Project Financial Management

176. **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.

177. **The Government's current efforts in public finance reforms will strengthen public sector financial management arrangements.** Ongoing PFM reforms and recommendations contained elsewhere in this Report should strengthen accounting and reporting, increase transparency and accountability, and strengthen internal controls as well as internal and external audits. As the government demonstrates progress in addressing its internal financial management control weaknesses, the Bank could begin by placing gradual reliance on elements of the Government’s financial management systems, reviewed on a case-by-case basis. Moving towards this increased reliance on national institutions and public financial management systems will require a phased approach based on demonstrable progress towards strengthening these institutions and systems.
B. Procurement

Project Procurement Risks

178. There are major procurement risks encountered in the many World Bank–financed projects undertaken in Uzbekistan. This creates an important fiduciary risk to the funds employed in the projects. A number of procurement-related issues and implementation risks were identified during the Country Portfolio reviews conducted jointly by the WB and ADB in October 2009.

179. Protracted contract reviews and approvals by the MFERIT remain the main reason for project delays. While a government resolution prohibits rejection of IFI-financed contracts, it also makes chairpersons of project tender committees personally responsible for price levels. This causes delays well beyond the norms established for processing these contracts. Although the MFERIT processing time is limited to 10 days by the regulation, in practice it takes much longer because of additional and frequent requirements of data and clarifications. Table 4 refers. The MFERIT-led committees do not accept the fact that procurements following World Bank procedures as stated in the loan agreements are International Agreements and as such, should be exempt from MFERIT control. The team believes strongly that full compliance with the World Bank loan agreements and procedures (including no price changes after contract signing) precludes additional involvement by MFERIT’s expertise, including the conduct of price verification.

Table 5: Duration and delays due to MFERIT contracts expertise in FY2008

<table>
<thead>
<tr>
<th>Projects</th>
<th>Contracts Submitted</th>
<th>Contracts Delayed</th>
<th>Delay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bukhara and Samarkand Water Supply</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Drainage, Irrigation and Wetlands Improvement</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Health II</td>
<td>9</td>
<td>9</td>
<td>Average = 25 days</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Range: 20 – 45 days</td>
</tr>
<tr>
<td>Basic Education Project</td>
<td>5</td>
<td>5</td>
<td>Average = 1 month;</td>
</tr>
</tbody>
</table>

Source: World Bank

* Delay duration includes a period from contract submission to MFERIT to issuance of expertise

180. Delays due to MFERIT contract expertise may result in a number of adverse consequences. These may include one or more of the following: the quotations' validity period expires; the goods' prices increase so that the contract cannot be implemented; bidders abandon a signed contract due to their uncertainty of outcome of the MFERIT review. Such practices have a negative effect on the Bank’s rating of the project implementation environment and portfolio status in Uzbekistan. Box H refers. For example:

76 Referred to as MFRETIT “expertise” within the government
77 Joint Resolution #1588/2007, MFERIT, Ministry of Finance and Customs Committee
The initial target dates for implementation of many projects of the Bank had to be extended. Recently completed Bank projects were extended by 1-3 years, mainly due to delays in procurement process, resulting from:
- protracted bidding process (including preparation of bidding documents and bid evaluation) as a result of delays in decision making by the ministries and project coordination councils,
- unpredictable and lengthy delays in MFERIT’s exercise of its contract oversight (“expertise”);
- The extension of project closing dates incurs additional administrative, financial and economic costs both for the Government and the Bank in terms of:
  - larger commitment charges,
  - adverse effect of project extension on the portfolio status that is one of the factors for defining IDA resources,
  - higher project operational and monitoring costs, and
  - higher indirect losses due to the failure to achieve project goals.
- The ADB and the WB presented their joint comments to the Government on the following key unresolved issues:
  - application of price examination/verification to IFI-financed contracts,
  - use of internal government regulations that conflict with international procurement principles used by IFIs;
  - tender committee chairperson held personally responsibility for price

### Box H: Sample List of Extended WB projects

| (1) | Rural Water Supply, Sanitation and Health: the initial project implemented was extended twice. The Initial Closing Date of December 2005 was extended to June 2008 and was completed in 2009; |
| (2) | Rural Enterprise Support Project: the initial Closing Date of July 2006 was extended twice to June 2008; |
| (3) | Bukhara-Samarkand Water Supply Project: the initial Closing Date of June 2007 was extended to June 2009; and subsequently extended again June 2010 |
| (4) | Basic Education Project Phase I: the initial Closing Date of June 2008 was extended to December 2009 and further to December 2010. |

Source: World Bank

### Systemic Project Risks in Procurement

181. **There are a number of systemic factors that increase the procurement risks for IFI-financed projects.** These include: excessive project implementation delays to projects resulting from MFERIT’s exercise of price verification and other “expertise” over IFI-financed projects; a cumbersome payments authorization process for Grants; and inadequate PIU staff salaries that result in the inability to attract and retain highly-qualified staff to perform the procurement function. These should all be addressed by the government.

182. **The exercising of contract price expertise (verification) over IFI-financed contracts is not in accordance with IFI procurement rules.** This has already been discussed in the Procurement chapter. The IFI project-related legal agreements, including the agreed procurement rules and procedures, should be strictly adhered to by the Government and such projects should be exempted from the MFERIT review process.
183. There are unnecessary delays in processing payments from projects financed by Bank grants. Internal government procedures for the review of all payments from grants are slow, non-transparent and can result in excessive delays in payment approvals. These results in an inefficient use of grant funds in the country. Furthermore, there is no accountability for the resulting project delays. This is another process that meets the INTOSAI criteria for high susceptibility to corruption.

184. The Treasury function should be given the responsibility to control the payments proposed for all grant-financed projects. They have the system and the capacity to implement the required ex ante controls over payments from grants. In addition, it will be done in a transparent manner. The government should consider this role change on a priority basis.

185. The government should revise the salary scales for PIU staff. Current salary levels were set ten years ago. The resulting salaries have fallen so low that it is now difficult to attract qualified staff to work on procurement activities on behalf of implementing agents of Government agencies or project entities.

Recommendations

Most recommendations arising from issues identified in this section have already been reported and analyzed in the relevant functional sections of the report (i.e. internal control, procurement).

- The government should review that salary scales for PIU staff and establish a process whereby the salary scales are reviewed periodically, preferably every three years.

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78 Minute #35/ 15 July 2000 of the Intergovernmental Committee for Development of Payments Mechanisms and Strengthening of the Budget Payments’ Discipline
VIII. SUMMARY FIDUCIARY RISK ASSESSMENT

186. **The PEFA scoring is set out in the PEFA manual.** A is the highest rating and D is the lowest. The Fiduciary risk ratings are: L for low, M for moderate, S for substantial and H for high. There is not necessarily a direct correspondence between the two rating systems.

<table>
<thead>
<tr>
<th>PEFA Indicator</th>
<th>PEFA Score</th>
<th>Risk Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dimension</strong></td>
<td><strong>Brief Description</strong></td>
<td></td>
</tr>
<tr>
<td><strong>PI 16: Predictability in funds availability for commitment of expenditures</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Extent to which cash flow are forecast and monitored</td>
<td>Length of cash flow forecast, the frequency of its update</td>
<td>C</td>
</tr>
<tr>
<td>(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment</td>
<td>The ability to plan and commit expenditures into the future by 6 months or more</td>
<td>A</td>
</tr>
<tr>
<td>(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs</td>
<td>The number of significant in-year adjustments to the forecast that were unanticipated.</td>
<td>B</td>
</tr>
<tr>
<td><strong>PI 17: Recording and management of cash balances, debt and guarantees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Quality of debt data recording and reporting</td>
<td>Extent to which debt records (domestic and foreign) are completed and updated monthly with high quality data.</td>
<td>NR</td>
</tr>
<tr>
<td>(ii) Extent of consolidation of the government’s cash balances</td>
<td>The frequency of the calculation of the cash balances and their consolidation</td>
<td>B</td>
</tr>
<tr>
<td>(iii) Systems for contracting loans and issuance of guarantees</td>
<td>Loans and guarantees are prepared using transparent criteria and known fiscal targets and approved by a single government entity</td>
<td>B</td>
</tr>
<tr>
<td>PEFA Indicator</td>
<td>PEFA Score</td>
<td>Risk Rating</td>
</tr>
<tr>
<td>----------------</td>
<td>------------</td>
<td>-------------</td>
</tr>
<tr>
<td><strong>Dimension</strong></td>
<td><strong>Brief Description</strong></td>
<td></td>
</tr>
<tr>
<td><strong>PI 18: Effectiveness of payroll controls</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Degree of integration and reconciliation between personnel records and payroll data</td>
<td>The degree to which the personnel database are linked, fully documented and maintained up to date on a regular basis. Reconciliations are carried out regularly in</td>
<td>D</td>
</tr>
<tr>
<td>(ii) Timeliness of changes to personnel records and the payroll</td>
<td>Extent to which the payroll records are updated and managed such that retroactive payments are rare.</td>
<td>NR</td>
</tr>
<tr>
<td>(iii) Internal controls of changes to personnel records and the payroll</td>
<td>The internal controls over payroll are strong and ensure the integrity of the data used for payroll purposes</td>
<td>C</td>
</tr>
<tr>
<td>(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers</td>
<td>Payroll audits are conducted regularly</td>
<td>D</td>
</tr>
<tr>
<td><strong>PI 19: Competition, value for money &amp; non-salary expenditure controls</strong></td>
<td>D+</td>
<td>H</td>
</tr>
<tr>
<td>(i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases</td>
<td>The extent to which there exists accurate data of all procurement activities and the degree of open competition resulting from [procurements.</td>
<td>D</td>
</tr>
<tr>
<td>(ii) Extent of justification for use of less competitive procurement methods</td>
<td>Extent to which non-competitive procurements are justified and comply with applicable regulations</td>
<td>C</td>
</tr>
<tr>
<td>(iii) Existence and operation of a procurement complaints mechanism</td>
<td>Extent to which a legislatively-based process for complaints in procurement is operating, subject to external oversight and makes data on complaints and their resolution public.</td>
<td>D</td>
</tr>
<tr>
<td>PEFA Indicator</td>
<td>PEFA Score</td>
<td>Risk Rating</td>
</tr>
<tr>
<td>----------------</td>
<td>------------</td>
<td>-------------</td>
</tr>
<tr>
<td><strong>Dimension</strong></td>
<td><strong>Brief Description</strong></td>
<td></td>
</tr>
<tr>
<td>PI 20: Effectiveness of internal controls for non-salary expenditure</td>
<td>B</td>
<td>M</td>
</tr>
<tr>
<td>(i) Effectiveness of expenditure commitment controls</td>
<td>The degree and comprehensiveness of expenditure commitment controls are in place and work effectively to limit expenditures to cash availability and budget levels</td>
<td>B</td>
</tr>
<tr>
<td>(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures</td>
<td>Other internal controls are comprehensive and effective, and are widely understood.</td>
<td>B</td>
</tr>
<tr>
<td>(iii) Degree of compliance with rules for processing and recording transactions</td>
<td>Extent of compliance with the rules.</td>
<td>B</td>
</tr>
<tr>
<td>PI 21: Effectiveness of internal audit</td>
<td>D+</td>
<td>S</td>
</tr>
<tr>
<td>(i) Coverage and quality of the internal audit function</td>
<td>Internal audit coverage of budget entities; the extent to which they operate using international standards and focus on systemic issues</td>
<td>D</td>
</tr>
<tr>
<td>(ii) Frequency and distribution of reports</td>
<td>Reports issued regularly on a fixed schedule, distributed to auditee and MOF</td>
<td>C</td>
</tr>
<tr>
<td>(iii) Extent of management response to internal audit findings</td>
<td>Prompt and effective management response to internal audit recommendations.</td>
<td>C</td>
</tr>
<tr>
<td>PI 22: Timeliness and regularity of accounts reconciliation</td>
<td>A</td>
<td>L</td>
</tr>
<tr>
<td>(i) Regularity of bank reconciliations</td>
<td>Bank reconciliation for all central government bank accounts take place on a daily basis at aggregate and detailed levels.</td>
<td>A</td>
</tr>
<tr>
<td>PEFA Indicator</td>
<td>PEFA Score</td>
<td>Risk Rating</td>
</tr>
<tr>
<td>---------------</td>
<td>------------</td>
<td>-------------</td>
</tr>
<tr>
<td><strong>Dimension</strong></td>
<td><strong>Brief Description</strong></td>
<td></td>
</tr>
<tr>
<td>(ii) Regularity of reconciliation, clearance of suspense accounts and advances</td>
<td>Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward.</td>
<td>A</td>
</tr>
<tr>
<td><strong>PI 23: Availability of information on resources received by service delivery units</strong></td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>(i) Availability of information on resources received by service delivery units</td>
<td>The PFM system effectively supports the tracking of information on all types of resources received by front-line service delivery units (such as primary schools and primary health care facilities) in cash and in kind on a quarterly basis. This information is compiled into consolidated budget execution reports and is regarded to be comprehensive.</td>
<td>A</td>
</tr>
<tr>
<td><strong>PI 24: Quality and timeliness of in-year budget reports</strong></td>
<td></td>
<td>C +</td>
</tr>
<tr>
<td>(i) Scope of reports in terms of coverage and compatibility with budget estimates</td>
<td>Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. However expenditure is covered at payment stage only while comparison of information on commitments is not possible yet.</td>
<td>C</td>
</tr>
<tr>
<td>(ii) Timeliness of the issue of reports</td>
<td>Reports are prepared quarterly and issued within 1 week of end of period.</td>
<td>A</td>
</tr>
<tr>
<td>(iii) Quality of information</td>
<td>Sufficient internal controls support the reliability of the data and there are no material concerns regarding data accuracy.</td>
<td>A</td>
</tr>
<tr>
<td>PEFA Indicator</td>
<td>PEFA Score</td>
<td>Risk Rating</td>
</tr>
<tr>
<td>---------------</td>
<td>------------</td>
<td>-------------</td>
</tr>
<tr>
<td><strong>PI 25: Quality and timeliness of annual financial statements</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Completeness of the financial statements</td>
<td>C+</td>
<td>M</td>
</tr>
<tr>
<td>A set of consolidated government financial statements is prepared annually. It include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities</td>
<td></td>
<td>B</td>
</tr>
<tr>
<td>(ii) Timeliness of submission of the financial statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The financial statements are submitted for external audit within 4 months of the end of the fiscal year, by April 5.</td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>(iii) Accounting standards used</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The financial statements are presented in consistent format over time with some disclosure of accounting standards.</td>
<td></td>
<td>C</td>
</tr>
<tr>
<td><strong>PI 26: Scope, nature and follow-up of external audit</strong></td>
<td>D+</td>
<td>S</td>
</tr>
<tr>
<td>(i) Scope and nature of audit performed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central government entities representing about 30% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only</td>
<td></td>
<td>D</td>
</tr>
<tr>
<td>(ii) Timeliness of submission of audit reports to the legislature</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audit reports on annual financial statements are submitted to the legislature within 1 month from their receipt by the audit office.</td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>(iii) Evidence of follow-up on audit recommendations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>There is clear evidence of effective and timely follow up on audit findings.</td>
<td></td>
<td>B</td>
</tr>
<tr>
<td><strong>PI 27: Legislative scrutiny of the annual budget law</strong></td>
<td>B+</td>
<td>M</td>
</tr>
<tr>
<td>(i) Scope of the legislature’s scrutiny</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislature covers the major aspects of the government’s fiscal, economic and priority areas as provided in the budget papers</td>
<td></td>
<td>B</td>
</tr>
<tr>
<td>Dimension</td>
<td>Brief Description</td>
<td>PEFA Score</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>(ii) Extent to which the legislature’s procedures are well-established and respected</td>
<td>Budget review processes are clear and respected. There are special organizations to examine the government submissions.</td>
<td>A</td>
</tr>
<tr>
<td>(iii) Adequacy of time for the legislature to respond to the Government’s proposals</td>
<td>The committees have enough time (2 months) to examine the budgets</td>
<td>B</td>
</tr>
<tr>
<td>(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature</td>
<td>Clear and respected rules for in-year budget adjustments, limited in scope and nature of changes</td>
<td>A</td>
</tr>
</tbody>
</table>

**PI 28: Legislative scrutiny of external audit reports**

| (i) Timeliness of examination of audit reports | Legislature completes its review of auditor’s report within a short (3 months) period. | C          | M           |
| (ii) Extent of hearings on key findings       | In-depth hearings take place consistently on key issues identified in the audit report. Responsible officers from audit entities testify before parliamentary committee. | A          |             |
| (iii) Issuance of recommended actions and their implementation by the executive | Legislature makes recommendations to the government that are then implemented by the government. | B          |             |

**Risk Rating Codes:**
- L = Low Risk
- S = Substantial Risk
- M = Moderate Risk
- H = High Risk
IX. SUMMARY OF CIFA RECOMMENDATIONS

Legislation

- The government should develop and submit to Parliament on a priority basis a Law on Public Procurement that meets international procurement standards and implement the enabling regulations and procedures.
- The government should create an independent Public Procurement Agency for the development of procurement policies and regulating the procurement process government-wide.
- A separate procurement appeals process should be established to accept and review complaints against the conduct of procurement activities by procuring entities.
- The government should also develop standard bidding and contractual documents and issue COM regulations making the use of these documents compulsory.
- The government should designate a government agency or committee to perform procurement monitoring and evaluation, including: the collection and consolidation of procured goods, services and works and preparation of procurement statistics and reports.
- The government should begin the process of implementation of modern internal audit by preparing a Law on Internal Audit that vests in the Minister of Finance the responsibility to implement an internal audit system across government. This internal audit system should comply with international standards on auditing.
- The government should implement the recommendation to change its budgets to an appropriations basis for individual ministries and other budget organizations.

Accounting

- The MOF should consider requesting the Cabinet of Ministers, at an appropriate time, to approve the phased implementation of appropriation-based budgeting for all aspects of its budgeting and reporting systems.
- The MOF should consider requesting the Cabinet of Ministers, at an appropriate time, to approve the move to international accrual accounting and begin the implementation of the initiative in the three proposed phases outlined in the MOF PFM Reform Strategy.
- The government’s accrual accounting standards should be fully compliant with the IPSAS standards for the accrual basis of accounting in the public sector.

GFMIS

- MOF should ensure that an experienced IT project manager is appointed to act in this capacity for the life of the implementation of the project.
- MOF should ensure that there is an active and highly visible executive sponsor for the project and a well-developed project plan with clear deliverables and target dates.
- There should be continuous consultation and involvement of the users of the GFMIS during its planning and implementation.

Reporting

- Quarterly budget execution reports should be in a single report that includes information at both the commitment and the payment stage of expenditure to allow for more meaningful monitoring of budget implementation and utilization of funds released.
The instructions for detailed application of the new accrual accounting framework by Budget Organizations, including the phasing of the implementation of the framework, should be fully developed by MOF and promulgated to all budget organizations.

MOF should ensure that all of its staff, Treasury staff and the local and regional Finance and Treasury staffs receive training on the accrual accounting and financial reporting reforms being implemented. Financial reporting should be an integral part of the MOF strategy of communications and training on the Treasury reforms.

The government should take steps to increase the scope and quality of financial information disclosed to the international community, Parliament and citizens on a regular basis.

The government should work with the Bank to develop an approach to partial use of its budget control system for Bank-financed projects.

**Procurement**

- The MOF to consider requesting the Cabinet of Ministers, at the appropriate time, to establish a strong legal, institutional and regulatory framework for the conduct of its public procurement activities.
- The government to consider designating a government agency for procurement monitoring and evaluation, including: collection and consolidation of data on procured goods, services and works and preparation of regular procurement statistics and reports for government, suppliers and the public.
- The government to ensure that all of the IFI-financed projects are designated as subject to International Contract rules and are exempted from the MFERIT expertise reviews.
- The government to consider a review of the salary scales for PIU staff and establish a process whereby the salary scales are reviewed periodically, preferably every three years.
- The government to clarify and publicize the MFERIT’s details on the application of their “import/export contract expertise”, also known as their contract review processes and criteria, employed in their decision-making on those contracts submitted for certification.
- The government to consider implementing a significant increase in the transparency of its procurement activities by the preparation of consolidated summary information and reporting on its procurement activities. This report could be prepared quarterly for the COM, and annually for the government, Parliament and the public, and should be subject to a regular review by CRU and an annual audit by the Chamber of Accounts.

**Internal Controls**

- MOF should develop and implement a new internal control strategy that takes into account the Treasury reforms and the associated GFMIS. The strategy should progressively modernize the internal control environment within government through modified internal control processes and new institutional arrangements, including establishment of internal audit units across government.
- The role of the Internal Control Division in the Treasury should be adjusted to permit the creation of an Internal Control and Audit Policy Unit for the development and implementation of policies on internal controls and internal auditing.
- MOF should strengthen its payroll controls on a priority basis.

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79 Also known in the EU PIFCs terminology as a Harmonization Unit
Internal Audit

- The government should establish an appropriate legal and institutional framework for internal state audit with authorities, responsibilities, scope established by Law, consistent with International standards for auditing and containing a management-approved Internal Audit Charter.
- The Ministry of Finance’s approved Public Financial Management Strategy 2007-2018 should be expanded to include a phased approach to internal audit reforms which build capacity in tandem with the on-going treasury reforms.
- The government should include in its Strategic Public Financial Management Strategic Plan 2007-2018 a strategy to progressively covert the CRU into a modern internal audit function in all government ministries and other key entities within Government.
- The current incentive structure for CRU should be eliminated as it is changed to a modern internal audit function.

External Audit

- The government to consider amending Decree UP-3592 to establish the key responsibilities of the Chamber of Accounts as those endorsed by international external auditing standards (INTOSAI) for external auditors worldwide.
- The government to consider proceeding with the submission of a draft Law on the Chamber of Accounts to Parliament for consideration and approval. This would inter alia, enhance the independence of the COA and would make it accountable to parliament rather than to the President.
- The COA to consider establishing a minimum annual audit coverage of entities by some factor (such as funds at risk, absolute budget percentage audited annually, etc.), based on annual work plan.
- To avoid compromising the independence of the Office, the COA should cease performing ex ante reviews of key budget and related documents that are the exclusive prerogative of the Executive.
- The COA should create a strategic audit development plan that includes the full adoption of international auditing standards and expanding the scope of audits to cover a larger proportion of the entities and expenditure each year.
- The COA to consider developing a program of collaboration with other well established SAIs that may include peer review²⁰ of its activities and other long-term capacity development activities, either through twinning arrangements or exchange programs.

Legislative Oversight

- The Parliament should state its support, at an appropriate time, for the concept of appropriations-based budgeting and request the government to implement the proposal.
- The Parliament to consider replacing the financial specialist experts from within the government who presently serve on its advisory panels for government budget reports and the COA audit report with a small unit of experts in public financial management and economics to work full time in supporting their respective budget committees in their analysis and review of the material submitted to their committees by the government.

PFM Reforms

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²⁰ One such entity that provides these services is SIGMA.
• The MOF should establish a PFM Coordination team to take charge of reforms in a holistic way to avoid fragmentation and overstretching of government capacity
## ANNEX I: HIGHLIGHTS OF PFM LEGISLATION

<table>
<thead>
<tr>
<th>Law</th>
<th>Key Provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Law on Treasury Execution of the State Budget (#664-II/2004)</td>
<td>The purpose of this law is to regulate the relationship between the Treasury execution of the State Budget (including State Targeted Funds) and extra-budgetary funds of budget organizations. It established the Treasury Single Account as a bank account operated by the Treasury for all revenues and expenditures of the State budget and extra-budgetary funds. It also contains the regulations for the functions, responsibilities and tasks of the Treasury and local treasury branches in Appendix I to the Law.</td>
</tr>
<tr>
<td>Law on Treasury Establishment Plan (#664-1/2004)</td>
<td>The Law establishes in a single, comprehensive document: the establishment of the Treasury. It includes: the planned Treasury functions; the planned legal framework for the establishment and operation of the Treasury; the Treasury organization plan, and its relationships with other organizations; the current technology plan; the current Treasury training plan; the budget and planned financing; the transition path for the establishment of the Treasury; and the risks, risk mitigation strategies and critical success factors.</td>
</tr>
<tr>
<td>Law on the Budget System (#130/2007)</td>
<td>The Law determines for the budget system: the organizational and administrative basis of the budget system; the principles and the structure of the State Budget; the procedures for preparation, review, adoption, and execution of the State Budget; the principles for revenue and expense generation of the State Budget; the relationship between the budgets within the structure of the State Budget; and the accounting, reporting, and control procedures while operating the funds of the State Budget.</td>
</tr>
<tr>
<td>Law on Improving Budget Classification Law 97/2005)</td>
<td>The Law introduced the new budget classification system according to the GFS-2001 budget classification system. It also applies to budget execution accounting classification and reporting. Under the new system the budget will in the medium term be guided by macroeconomic and financial objectives and constraints. The adoption of the new classification distinguishes between the economic, administrative and functional classifications, makes a clear distinction between revenues, expenditures and financing transactions, as well as between transfers and exchange transactions.</td>
</tr>
<tr>
<td>Presidential Resolution. On Measures for Further Developing the Treasury System of State Budget Execution, # PP-594/February 28,</td>
<td>Establishes further reforms of the budget system including: the establishment of the MOF Treasury, definition of its core responsibilities as: cash execution of the State Budget, responsibilities including the distribution of the funds of the State Budget, and the establishment of local branches.</td>
</tr>
<tr>
<td>Year</td>
<td>Description</td>
</tr>
<tr>
<td>------</td>
<td>-------------</td>
</tr>
<tr>
<td>2007</td>
<td>of revenues collected among the budgets of different levels, the execution of the smeta for budget recipients, and the preparation of statements of budget execution; maintaining the TSA; mandatory registration for all budget-funded contracts with suppliers of goods and major construction contracts.; having regard for quality assurance, relevance and pricing of signed contracts; make payments for goods on behalf of budget recipients directly to suppliers’ accounts, maintaining accounting and reporting for the Treasury system of State Budget execution; servicing internal and external national debt and the execution of national guarantees; the organizational design of the Treasury and its territorial branches, the authority of the Minister of Finance to make modifications; and the specifications on the retention and remuneration of the Treasury Head.</td>
</tr>
<tr>
<td></td>
<td>Resolution of the Ministry for Foreign Economic Relations, Investments and Trade, the Ministry of Finance, the State Customs Committee of the Republic of Uzbekistan, On a Procedure for Registration of Export and Examination of Import Contracts (Agreements) Concluded by Economic Establishments of The Republic of Uzbekistan with The Ministry for Foreign Economic Relations, Investments and Trade, # HH01-01-377 / June 30, 2006</td>
</tr>
<tr>
<td></td>
<td>COM Resolution #302/2003 (revised) on competitive bidding in capital construction in Uzbekistan</td>
</tr>
<tr>
<td></td>
<td>COM Resolution: On measures to improve organization of tenders,</td>
</tr>
</tbody>
</table>
| Res #456 2000, (updated 2003, 2004, 2005, 2008, 2009) | the vendor. The Regulation defines the mechanism of organization of tenders for purchases of raw materials, components, both imported to, and manufactured in, the Republic of Uzbekistan, purchase of which is financed at the expense of the national budget, off-budget purpose funds consolidated in the national budget, foreign credits on guaranteed by the Government and foreign grants extended by international and foreign financial institutions. This includes the group of World Bank, EBRD (European Bank for Reconstruction and Development), ADB (Asian Development Bank) Japan Bank of International Cooperation, KfW Bank, etc. However, these Regulations are not applicable to:

i. tenders conducted in accordance with other resolutions adopted by the Cabinet of Ministers of the Republic of Uzbekistan and

ii. if the terms of extension of foreign credits and grants stipulate another procedure to effect purchases. |

| State Committee for Architecture and Construction., *Instructions on the Holding of Two-stage bidding for architectural Projects* #1303/2003 | This regulation defines the sequence and content of the organization and conduct for two-stage competitive tenders in capital construction. It is based on the terms and requirements of the order established by COM resolution #302. Requirements of these regulations cover construction works financed by means of centralized sources (state capital investments), means of state administration, and state enterprises in the territory of Uzbekistan. |
The global fiduciary risk rating for Uzbekistan is substantial. This represents a consolidated assessment of all of the areas of public financial management and procurement operations studied by the CIFA team. These ratings are not a mechanical translation of PEFA scores; the teams’ judgment and expertise in the functional areas have also been employed to arrive at the component and the global assessment. Box 1 provides a summary of these assessments.

<table>
<thead>
<tr>
<th>Component</th>
<th>Risk Rating and Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budget Execution</strong></td>
<td>LOW RISK: The implementation of the treasury system and planned further enhancements has given the government a strong system of ex ante control over budget spending for all budget organizations, extra-budgetary funds and accounts. Significant improvements in certainty of in-year cash releases.</td>
</tr>
<tr>
<td><strong>Accounting</strong></td>
<td>LOW RISK: The government should issue an official resolution of decree announcing the adoption of international standards for cash-based accounting and its intention to migrate progressively towards full accrual accounting.</td>
</tr>
<tr>
<td><strong>Recording</strong></td>
<td>MODERATE RISK: The government is embarking on a large IT systems project, which has inherent risks that must be carefully managed.</td>
</tr>
<tr>
<td><strong>Reporting</strong></td>
<td>SUBSTANTIAL RISK: Underlying data quality is a function of the accounting employed. There is a major requirement to increase the transparency of all budget, budget execution, COA Audits and other financial data to better inform the government, Parliament and the public on the nation’s financial condition and results of operations.</td>
</tr>
<tr>
<td><strong>Procurement</strong></td>
<td>HIGH RISK: There has been no progress in establishing internationally –compliant procurement systems. There is no Law on Public Procurement, no unique agency for procurement policy development, training and monitoring of implementation, no independent procurement complaints resolution agency and no internationally-standard bidding and contract documents, bid evaluation procedures.</td>
</tr>
<tr>
<td><strong>Internal Control</strong></td>
<td>SUBSTANTIAL RISK: The payroll controls are weak and not exercised on a timely basis. Other non-payroll spending is similarly weak. Although the CRU provides strong ex post control inspections, its resources are insufficient for the coverage targets stated.</td>
</tr>
<tr>
<td><strong>Internal Audit</strong></td>
<td>SUBSTANTIAL RISK. The government has not adopted modern internal audit. The CRU resources are insufficient to obtain their audit coverage of budget organizations once every three years.</td>
</tr>
<tr>
<td><strong>External Audit</strong></td>
<td>SUBSTANTIAL RISK: The COA does not appear to follow international standards in the exercise of its audit planning, operations, reporting or quality control. Their operations are opaque and audit recommendations are shielded from public view.</td>
</tr>
<tr>
<td><strong>Parliamentary</strong></td>
<td>MODERATE RISK: Parliament exercises strong oversight on</td>
</tr>
</tbody>
</table>
Box 1. Component Risk Ratings

<table>
<thead>
<tr>
<th>Component</th>
<th>Risk Rating and Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oversight</td>
<td>government budgets and budget spending. They should be provided with expert staff support to replace the use of experts from government sources, which constitute a conflict of interest on their part.</td>
</tr>
<tr>
<td>Bank-funded Projects</td>
<td>HIGH RISK: This is primarily due to the involvement of MFERIT in the exercise of their review (&quot;expertise over IFI projects&quot;). The complex, non-transparent bid approval process can be a source of potential corruption.</td>
</tr>
</tbody>
</table>
### ANNEX III: IMPLEMENTATION OF PRIOR RECOMMENDATIONS

<table>
<thead>
<tr>
<th>PFM Component</th>
<th>Recommendation</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BUDGET EXECUTION</strong></td>
<td>CFAA: 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.</td>
<td>Law on Treasury Execution of the State Budget (#664-II/2004) provides for the control of budget execution. The Law on the Budget System (#130/2007) defines its operational processes.</td>
</tr>
<tr>
<td></td>
<td>IMF (2003): Establish a Treasury to improve budget execution control, including a TSA, rationalized treasury branch system, daily financial planning and cash management, stronger payment arrangements and enhanced short-term debt management to support cash management. Regulatory provisions should be promulgated which set out procedures for efficient daily management of cash, payables and receivables.</td>
<td>Treasury established in law and in a rationalized MOF organization. Strict SMETA(^1) controls now administered by Treasury. Direct treasury payments to suppliers now the norm. Debt and cash management: The team was not provided with any information on its debt management functions. The cash management activities are in a nascent state and will require some time to evolve. Given the nascent state of cash management, there is the need to develop regulations and procedures for cash management once the supporting systems have been developed and implemented.</td>
</tr>
<tr>
<td>PER:</td>
<td>Implementation of the Treasury Single Account, associated payment system reforms and the introduction of commitment accounting should be finalized and implemented as part of GFMIS implementation. The Treasury should continue to administer existing systems pending GFMIS implementation.</td>
<td>TSA and payment reforms already implemented in advance of the GFMIS, using interim systems developed within the Treasury organization. Commitment accounting is developing and will be stronger with the release of the T-III internal treasury system.</td>
</tr>
<tr>
<td><strong>ACCOUNTING</strong></td>
<td>CFAA (2004): Continue the phased development of accounting and reporting standards that conform to international standards.</td>
<td>The government’s PFM Reform Strategy 2007-2018 identifies and commits it to a phased implementation of accrual based accounting for all government activities. IMF reported that accounting framework to be used is yet to be documented and approved (Jan 2010). Not implemented</td>
</tr>
<tr>
<td></td>
<td>• Continue phased development of accounting and reporting standards. Begin with the cash elements of the new accounting standards, then progressively add accrual elements of the accounting standards added, together with accounting policies;</td>
<td></td>
</tr>
</tbody>
</table>

\(^1\) The SMETA (Smeta Raskhodov = cost estimate or budget) is the approved budget of a budget organization, broken down into the three levels of economic classification on a monthly and annual basis.
<table>
<thead>
<tr>
<th>PFM Component</th>
<th>Recommendation</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PFM Component</strong></td>
<td><strong>Recommendation</strong></td>
<td><strong>Status</strong></td>
</tr>
<tr>
<td>- The annual budget execution report should be subject to audit once the (IPSAS) cash accounting standard is implemented. 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>Incorporated into the PFM Reform Strategy 2007-2018</td>
<td></td>
</tr>
<tr>
<td><strong>CFAA (2004):</strong> Continue the phased development of accounting and reporting standards that conform to international standards.</td>
<td>The government’s PFM Reform Strategy 2007-2018 identifies and commits it to a phased implementation of accrual based accounting for all government activities. IMF reported that accounting framework to be used is yet to be documented and approved (Jan 2010). Not implemented</td>
<td></td>
</tr>
<tr>
<td>- Continue phased development of accounting and reporting standards. Begin with the cash elements of the new accounting standards, then progressively add accrual elements of the accounting standards added, together with accounting policies;</td>
<td>Incorporated into the PFM Reform Strategy 2007-2018</td>
<td></td>
</tr>
<tr>
<td>- The annual budget execution report should be subject to audit once the (IPSAS) cash accounting standard is implemented. 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></td>
<td></td>
</tr>
<tr>
<td><strong>IMF(2003)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- A uniform chart of accounts should be defined to replace the separate charts of accounts currently in use, and should be based on the Government Finance Statistics 2001 structure and the budget classification.</td>
<td>Completed and will be fully introduced on January 1, 2011</td>
<td></td>
</tr>
<tr>
<td>- Further development of the COA should rest with the Treasury</td>
<td>This function remains with the MOF</td>
<td></td>
</tr>
<tr>
<td>- Reconciliation procedures should be updated to improve control, and to reflect the new processing and accounting procedures associated with accrual accounting. These should be reflected in the accounting instructions and reflected in the GFMIS functional requirements.</td>
<td>Partially implemented and will be fully implemented through the application of the GFMIS application</td>
<td></td>
</tr>
<tr>
<td>- New public sector accounting standards based on international practices, including the accrual recognition principle, should be defined and gradually adopted in a long-term strategy. Implement only the first stages of implementation of accrual accounting.</td>
<td>Not officially approved in law; promulgated in MOF’s PFM Reform Strategy 2007-2018, April 2007. Requires a formal decision by the government</td>
<td></td>
</tr>
<tr>
<td><strong>GFMIS</strong></td>
<td></td>
<td>The government accepted all of these recommendations as an integral</td>
</tr>
</tbody>
</table>

The IMF had strongly supported its development in a series of recommendations relating to its design and implementation, beginning in 2003 and continuing to
Other relevant material can be found in the 2003 Public Financial Management Reform Program, the Bank’s 2004 CFAA and the Public Expenditure review both endorsed the previous IMF recommendations for the GFMIS and the Public Financial Management Reform Project (2005) dealt extensively with the requirements for such a system.

<table>
<thead>
<tr>
<th>PFM Component</th>
<th>Recommendation</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>date.</td>
<td>component of its comprehensive Treasury reforms</td>
</tr>
<tr>
<td></td>
<td>Other relevant material can be found in the 2003 Public Financial Management Reform Program, the Bank’s 2004 CFAA and the Public Expenditure review both endorsed the previous IMF recommendations for the GFMIS and the Public Financial Management Reform Project (2005) dealt extensively with the requirements for such a system.</td>
<td></td>
</tr>
<tr>
<td>REPORTING</td>
<td>CFAA: Train users and providers of financial information on the benefits of public sector accounting and financial reporting.</td>
<td>Partially completed</td>
</tr>
<tr>
<td>IMF (2003):</td>
<td>- The BSL should have specific provisions in the BSL regarding a complementary accounting period at the end of the year to ensure that:</td>
<td>These provisions had been legalized in the Treasury Systems Law (2004) as well as Resolution 414.</td>
</tr>
<tr>
<td></td>
<td>o transaction pertaining to financial year are accounted for in that year,</td>
<td>Implemented to a large extend</td>
</tr>
<tr>
<td></td>
<td>o all transactions pertaining to a year are set off against the budget appropriations for that year,</td>
<td>Implemented</td>
</tr>
<tr>
<td></td>
<td>- The closing cash balance for the year reconciles with the bank reported by the Central Bank;</td>
<td>Implemented</td>
</tr>
<tr>
<td></td>
<td>- The annual reports should indicate the commitments carried forward to next year and the payables and receivables:</td>
<td>Not implemented</td>
</tr>
<tr>
<td></td>
<td>- The annual report should include a statement of contingent liabilities;</td>
<td>Not implemented</td>
</tr>
<tr>
<td></td>
<td>Permit budget units to transfer unused budget allocations to the development funds</td>
<td>Done in accordance with Resolution 414</td>
</tr>
<tr>
<td>PROCUREMENT</td>
<td>Improving Procurement Procedures and Practices</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Abolish outdated cost estimation system based on 1991 reference prices and move to a current (2004) reference basis and include price contingencies in price contingencies in the estimate (by 2004)</td>
<td>Implemented</td>
</tr>
<tr>
<td></td>
<td>- Discontinue mandatory use of state design institutes (by 2004)</td>
<td>Implemented. Private design institutes in wide use</td>
</tr>
<tr>
<td></td>
<td>- Define more transparent procurement practices in a new COM Resolution and a new public procurement law (by 2004)</td>
<td>Not Implemented</td>
</tr>
<tr>
<td></td>
<td>- Abolish contract registration system for foreign currency contracts (by 2004).</td>
<td>Not Implemented</td>
</tr>
<tr>
<td></td>
<td>- Designate the State and Social Development</td>
<td></td>
</tr>
</tbody>
</table>

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It contained a set of recommended functional requirements for a GFMIS to cover commitments and expenditure processing.
<table>
<thead>
<tr>
<th>PFM Component</th>
<th>Recommendation</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PFM Component</strong></td>
<td><strong>Recommendation</strong></td>
<td><strong>Status</strong></td>
</tr>
<tr>
<td></td>
<td>Academy as the lead institution for the training of public officials in procurement. Require the Institute to develop the necessary curriculum for this training.</td>
<td>Partially Implemented. The MOF training centre provides procurement training. The Academy lacks the budgetary resources to meet this recommendation.</td>
</tr>
<tr>
<td><strong>PROCUREMENT</strong></td>
<td><strong>Audit &amp; Anti-corruption Measures</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Implement ex ante MOF controls over high-value contracts</td>
<td>Implemented. Price verification by Treasury in place. MOF is member of all contract tender committee.</td>
</tr>
<tr>
<td></td>
<td>- Ensure the separation of procurement functions in all procuring entities</td>
<td>Implemented. Now performed by the financial officers in procuring entities. May not be done in small entities.</td>
</tr>
<tr>
<td></td>
<td>- Increase the frequency of <em>ex post</em> CRU control audits of procurement transactions</td>
<td>Implemented. CRU conducts <em>ex post</em> procurement audits, as does the Chamber of Accounts.</td>
</tr>
<tr>
<td></td>
<td>Define procurement-related fraud and corruption as criminal offenses under Criminal Law and prosecute offenders as such.</td>
<td>Not Implemented No annual procurement reports prepared and sent to Parliament</td>
</tr>
<tr>
<td></td>
<td>- Conduct annual efficiency assessments of the performance of public procurement activities.</td>
<td></td>
</tr>
<tr>
<td><strong>INTERNAL CONTROLS</strong></td>
<td><strong>CFAA</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>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.</td>
<td>No work has been initiated in this direction.</td>
</tr>
<tr>
<td></td>
<td>Acquire and implement a GFMIS to support improved internal control over spending by Treasury.</td>
<td>Implementation underway: GFMIS is being introduced in the Treasury under the ADB funded PFMRP</td>
</tr>
<tr>
<td></td>
<td>Ensure that Treasury assumes responsibility for all budget and payment controls for budget entities’ operations</td>
<td>Implemented: the treasury now controls all payments of budget entities, with plans in 2010 to bring in extra-budgetary accounts and special accounts under Treasury control.</td>
</tr>
<tr>
<td><strong>INTERNAL AUDIT</strong></td>
<td><strong>IMF (2002):</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- An internal audit function should be established within the treasury at the same time as the treasury is established</td>
<td>Proposals have been submitted to the government for formal establishment of Internal audit function in the Treasury, and approval is awaited.</td>
</tr>
<tr>
<td></td>
<td>- The treasury’s internal audit function should operate according to international internal audit standards</td>
<td>Appropriate tools have been developed, including Internal Audit Manual and draft Law on internal audit, and training has been provided in the conduct of modern internal audit.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>No changes to the operations of CRU are envisaged in the near future.</td>
</tr>
<tr>
<td>PFM Component</td>
<td>Recommendation</td>
<td>Status</td>
</tr>
<tr>
<td>---------------</td>
<td>----------------</td>
<td>--------</td>
</tr>
<tr>
<td>CFAA (2004):</td>
<td></td>
<td>Decision pending. Framework for establishment of an internal audit division within the treasury has been developed, and is awaiting approval by the government.</td>
</tr>
<tr>
<td></td>
<td>Implement an internal audit team within the new Treasury directorate.</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>Set minimum requirements for the competence and skill requirements of internal auditors within Government.</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>Solicit development partner 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 framework in the Government.</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>Develop a long-term strategy to bring internal controls into compliance with international control standards.</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>Implement 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.</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>Redefine the respective roles and responsibilities of CRU and Internal audit, and require the creation of internal audit units in all major budget entities.</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>Require the creation of internal audit units in all major budget entities;</td>
<td>Decision pending</td>
</tr>
<tr>
<td></td>
<td>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.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXTERNAL AUDIT (COA)</th>
<th>CFAA (2003):</th>
<th>Approved in the 2007 amendments to the Budget System Law</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The COA should establish a legal basis for its activities. The government should ensure that the provisions in the draft law require that the Chamber of Accounts to report to the Budget and Finance committee of the Oliy Majlis.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The dual reporting relationship to the President and Parliament may provide both the authority and protection for the COA as it conducts its work (and) 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.</td>
<td>Not implemented</td>
</tr>
<tr>
<td>PFM Component</td>
<td>Recommendation</td>
<td>Status</td>
</tr>
<tr>
<td>---------------</td>
<td>----------------</td>
<td>--------</td>
</tr>
<tr>
<td>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.</td>
<td>Not done</td>
<td></td>
</tr>
<tr>
<td>The annual audit program (and) the audit reports of the COA (should be made) available to the Oliy Majlis or the public.</td>
<td>The annual audit report is not yet publically available.</td>
<td></td>
</tr>
<tr>
<td>The COA should conduct staff recruitment based on clearly defined skills and competences, many of which are new to auditors in Uzbekistan.</td>
<td>Staff all have university degrees in law or economics</td>
<td></td>
</tr>
<tr>
<td>- Staff should have the necessary education and experience to learn modern auditing techniques that conform to international auditing standards.</td>
<td>Partially implemented</td>
<td></td>
</tr>
<tr>
<td>- The COA should develop a capacity development program that recognizes that in the short term it will have limited capacity to absorb new concepts and techniques.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>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. Medium term (one to three years).</td>
<td>Done</td>
<td></td>
</tr>
<tr>
<td>Train the COA auditors in the conduct of international-standards based financial attestation audits. Initially the COA should carry out a number of pilot audits; closely monitoring the process and the results of this work.</td>
<td>Not implemented</td>
<td></td>
</tr>
<tr>
<td>The COA should build closer links with both Houses of the new reformed Parliament. Long term (over three years)</td>
<td>Done</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>Such financial reports have not yet been prepared by government</td>
<td></td>
</tr>
<tr>
<td>IMF (2003):</td>
<td>Completed</td>
<td></td>
</tr>
<tr>
<td>- Make provision in the BSL for the Chamber of Accounts to review the annual accounts of the government before accounts are submitted to the Oliy Majlis. Among other issues, the audit should also bring out major deviations of actual figures from budget appropriations and an explanation of the reasons for such deviations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EU** (2005):</td>
<td>A Draft Law had been prepared but no decision had been taken to proceed with it.</td>
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<td>Adoption and passing the necessary legislation to establish the Chamber of Accounts as the Supreme Audit Institution of the Republic of Uzbekistan with the necessary legislation for its independence laid down in the Constitution; covering adequate legal protection against any interference; complete</td>
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<thead>
<tr>
<th>PFM Component</th>
<th>Recommendation</th>
<th>Status</th>
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<tbody>
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<td></td>
<td>independence; and an audit mandate and (consequential) amendments to the Audit Law.</td>
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