Kyrgyz Republic
Country Fiduciary Assessment Update 2007

November 10, 2007

Operational Policy and Services
Europe and Central Asia Region
## Currency Equivalents

Currency unit = Kyrgyz Soms

US$1 = KGS 37.96

(As of June 2, 2007)

## Government Fiscal Year

January 1 - December 31

## Abbreviations and Acronyms

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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BLI</td>
<td>Baseline Indicator</td>
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<tr>
<td>CDS</td>
<td>Country Development Strategy</td>
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<td>CFAA</td>
<td>Country Financial Accountability Assessment</td>
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<td>CFAU</td>
<td>Country Fiduciary Assessment Update</td>
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<tr>
<td>CIS</td>
<td>Commonwealth of Independent States of the Former Soviet Union</td>
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<td>COA</td>
<td>Chart of Accounts</td>
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<td>COSO</td>
<td>Committee of Sponsoring Organizations of the Treadway Commission</td>
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<td>CPAR</td>
<td>Country Procurement Assessment Report</td>
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<td>CPI</td>
<td>Compliance/Performance Indicators</td>
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<td>DOE</td>
<td>Department of Education</td>
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<td>DFID</td>
<td>Department for International Development of the United Kingdom</td>
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<td>ESW</td>
<td>Economic Sector Work, World Bank</td>
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<td>FSU</td>
<td>Former Soviet Union</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GFS</td>
<td>Government Finance Statistics</td>
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<td>GOK</td>
<td>Government of the Kyrgyz Republic</td>
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<td>GSAC</td>
<td>Governance Sector Adjustment Credit</td>
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<td>GTAC</td>
<td>Governance Technical Assistance Credit</td>
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<td>HRMIS</td>
<td>Human Resources Management Information System</td>
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<td>IDF</td>
<td>Institutional Development Fund of the World Bank</td>
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<td>IFI</td>
<td>International Fiduciary Assessment</td>
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<td>INTOSAI</td>
<td>International Organization of Supreme Audit Institutions</td>
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<td>IPSAS</td>
<td>International Public Sector Accounting Standards</td>
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<td>MHIF</td>
<td>Mandatory Health Insurance Fund</td>
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<td>MOE</td>
<td>Ministry of Education</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>NAO</td>
<td>National Audit Office of the United Kingdom</td>
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<td>NBKR</td>
<td>National Bank of the Kyrgyz Republic (Central Bank)</td>
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<td>NPRS</td>
<td>National Poverty Reduction Strategy</td>
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<td>NPTC</td>
<td>National Procurement Training Center</td>
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<td>OECD-DAC</td>
<td>Organization for Economic Co-operation and Development–Development Assistance Committee</td>
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<td>PEFA</td>
<td>Public Expenditure and Financial Accountability</td>
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<td>PER</td>
<td>Public Expenditure Review</td>
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The CFAU team comprised Naushad Khan, Lead Procurement Specialist (Team Leader); John Otieno Ogallo, Senior Financial Management Specialist; Nurbek Kurmanaliev, Procurement Specialist (ECSPS); Gulnara Suyerbayeva, Consultant; and Altyiay Beishenalieva, Consultant. The CFAU team received valuable inputs from the PPER team, led by Eka Vashakmadze and Roland Clarke; as well as Irina Goncharova, Program Assistant, ECCKG.
KYRGYZ REPUBLIC
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EXECUTIVE SUMMARY

Introduction
1. The World Bank staff, in collaboration with government officials, assessed the public procurement system of the Kyrgyz Republic. The Country Procurement Assessment Report (CPAR) was finalized in December 2002, and the Country Financial Accountability Assessment (CFAA) in 2003. A Public Expenditure Review (PER) was finalized in 2004; and in early 2006, the Public Expenditure and Financial Management Assessment (PEFA). These reports made recommendations to strengthen public financial management, including procurement. This report takes stock of developments since 2002 within the Public Financial Management (PFM) Framework. It identifies the recommendations that have been implemented, and it lays out a road map to implement remaining reforms. It provides a basis upon which the Government of the Kyrgyz Republic (GOK) can formulate a capacity-building plan to improve its fiduciary system. Donors can use the results of this update in two ways—first, to develop strategies for assisting the capacity development plan, and second, to mitigate risks in individual operations. The country can use the information to monitor its fiduciary systems and the extent to which ongoing reform initiatives are improving performance.

2. This assessment was prepared in close collaboration with government counterpart teams and other donors. The teams analyzed relevant pieces of legislation, gathered feedback through workshops, and conducted interviews with the Government, the private sector, and civil society. The report incorporates comments on earlier drafts and suggestions received from the government, including the Ministry of Finance (MOF), the Chamber of Accounts (COA), Ministry of Economic Development and Trade and the State Agency on Public Procurement and Materials Reserve (SAPPMR).

Progress toward PFM reform
3. An action plan developed in June 2006 signified the government's commitment to work closely with development partners on PFM reforms. The 2006 action plan addressed key elements of the public finance management structure. Albeit uneven, some progress has been made in implementation. A new budget classification was introduced in January 2007, consistent with GFS 2001 principles. The new classification serves as a basis for consistent and transparent reporting, and it provides greater flexibility for budget organizations during budget execution. A new chart of accounts has also been developed with support from DFID and the World Bank.

4. USAID has provided assistance to introduce international accounting standards in the public sector. A report recommending cash-based Public Sector International Accounting Standards (IPSAS) was sent to the government at the end of 2006. There appears to be general support for implementation of the cash-based IPSAS, and the Ministry of Finance has issued Order No. 109 to improve public sector accounting
and reporting. The new chart of accounts has not been implemented, because views on it differ among government officials. The new Division of Methodology of Financial Reporting and Internal Audit in the Ministry of Finance is expected to develop a roadmap to introduce accounting standards and the new chart of accounts. Technical assistance will be required to support the new division as the ministry lacks expertise on international accounting standards.

5. **IPSAS and the new chart of accounts will require trained personnel.** The Ministry of Finance should seek donor support to outsource public sector financial management and accounting training to well-experienced training organizations in the Kyrgyz Republic. This will help to ensure continuity of training and consistent quality standards. To create a critical mass of trained officials to sustain reforms in public finance management, the ministry should seek donor assistance to establish a training center for public sector accountants. Additional training in budget classification is required for staff of budget organizations and Treasury and for staff in the regions.

6. **Developing the new chart of accounts is running in parallel with modernizing Treasury operations under the Governance Technical Adjustment Credit (GTAC) program.** This involves installation of a computerized Treasury system with minor overhaul of Treasury business processes. The Treasury, with the support of DFID and the World Bank, has presented draft formats for new cash planning processes to the Ministry of Finance. These will result in significant business process changes, including incorporation of commitments into treasury procedures, if approved.

7. **The Ministry of Finance should finalize the chart of accounts and implement the cash-based IPSAS as recommended under the USAID-funded project.** These measures will help to unify accounting among budget organizations and to ensure reliability and comparability of financial reporting. The Government should also seek technical assistance in moving toward consolidated financial statements for the government as a whole.

8. **Personnel and payroll processes are still decentralized.** Line ministries are responsible for payroll within accepted remuneration guidelines. Decentralization of payroll to line ministries has resulted in a lack of effective, consistent controls. The quality of authorization and audit trail procedures over payroll is also questionable. The Government should centralize and automate the payroll function. A unified pay scale for civil service, tied to job descriptions, should eliminate the current, complicated multiple pay scales and simplify payroll tracking. In addition, control weaknesses associated with bonus distribution need to be strengthened. Related legislation in this area provides little guidance, which leaves too much room for managerial discretion and the potential for fraud. A pilot project in the Ministry of Finance will attempt to develop a unified pay scale and a more transparent performance management system to simplify payroll tracking and rationalize bonuses.

9. **The Government should create a secure, centralized database of public sector employees.** Payroll processing should be computerized to strengthen internal controls.
The Government should also initiate review of bonuses and allowances to public officials. The structure of allowance payments should be based on transparent criteria, such as performance appraisals.

10. **Several initiatives have introduced the internal audit function to the public sector.** A working group of government officials and experts from development partners has developed a legal framework for internal audit. A draft law on internal audit was distributed to line ministries for comment before final submission to the Government in April 2007. The UK Department for International Development (DFID) is providing technical advice to the Ministry of Finance to help resolve disputes over the draft law. Subsidiary regulations and standards are also being prepared. A new Division of Methodology of Financial Reporting and Internal Audit was created as part of the restructuring of the Ministry of Finance. The new division should play a coordinating role in facilitating dialogue.

11. **With donor support, several line ministries have created internal audit units.** Their effectiveness has not yet been assessed; however, significant training to develop skills and enhance the internal audit function has been provided under the DFID program. The Union of Accountants and Auditors (UAA) is also participating in training. A draft audit manual is being used as the basis for training. DFID has also undertaken joint audits with the Ministry of Health and the Mandatory Health Insurance Fund. Further joint audits during the second half of 2007 should provide additional hands-on training.

12. **Despite some progress, internal controls and internal audit concepts are still a source of confusion among many authorities.** A legal framework for internal control and internal audit has not yet been set up. There are too few trained public sector officials capable of performing internal audits. Even in the ministries and agencies where internal audit functions have been formally established, the focus is frequently on intermittent inspections rather than continuous internal controls. Technical assistance may be needed from donors to build permanent frameworks that institutionalize managerial accountability and internal audit. The lack of a robust, overarching legal framework greatly impedes units that are currently trying to put internal audit into operation. Development partner agencies should support accelerated enactment of the Law on Internal Audit.

13. **Need to clarify role of Ministry of Finance in internal audit function.** The role of the MOF Financial Control Division needs to be clarified to remove ambiguity and address doubts over the direction taken by the Government to establish a modern internal audit function. Fears should be addressed that the control and revision units will be revived, which would duplicate the work done by the COA.

14. **Little progress has been made on external audit capacity.** Despite a much improved legal framework for external audit, the Chamber of Accounts, the supreme audit institution for the country, functions largely as an inspection and control unit that ensures compliance with regulations. The chamber does not apply auditing standards for planning and conducting its work. In the absence of consolidated government statements
(even for line ministries), no financial statements audits have been possible. COA recently conducted its first pilot performance audit of the Rural Education Project of the Ministry of Education, with support from USAID and using INTOSAI audit standards. Such joint pilot audits are encouraged, as they help build COA capacity to perform audits as required by law, while applying modern audit techniques.

15. **The Chamber of Accounts needs significant capacity building.** This is necessary in order to make the transition from an inspection or control body to an external audit institution capable of providing third-party assurance on the use of public funds. COA will benefit from a twinning program with the UK National Audit Office, made possible under the Manas Taalimi Health Reform Program. An IDF grant has also been approved by the World Bank to develop capacity and help the chamber in the reform process.

16. **The independence of the Chamber of Accounts is a matter of concern following a constitutional amendment in November 2006.** The amendment granted power to the President to hire and fire the COA chairman without parliamentary approval. External audit reform could therefore be held hostage to political whims. A review of the legislation to grant the Chamber of Accounts independence from the executive is needed. COA should also strengthen its institutional base, develop a long-term strategic framework, and transform itself into a credible institution effectively representing transparency and accountability in public expenditure management.

**Public procurement**

17. **The Public Procurement Law (PPL) of the Kyrgyz Republic came into effect on May 24, 2004.** The PPL provides for a decentralized procurement system. Tenders must be announced publicly, which greatly strengthens transparency. The State Agency on Public Procurement and Materials Reserve (SAPPMR) is responsible for assisting public entities in conducting procurement according to the law.

18. **The Government implemented most of the Bank’s recommendations in designing the Public Procurement Law, and many recommendations for organizational reform have been implemented.** One of the most important developments since the 2002 CPAR was the establishment of the National Procurement Training Center (NPTC), which was supported by a grant from the World Bank. There are concerns about the sustainability of NPTC when the Bank grant comes to an end.

19. **Implementation of the 2004 public procurement law has been weak.** Despite a comprehensive legal framework, the public procurement system suffers from significant deficiencies in practice. The PPL assigns a support and oversight role to SAPPMR; however, SAPPMR is unable to fulfill this role efficiently or objectively. SAPPMR lacks adequate capacity. Moreover, its involvement in the actual conduct of procurement—clearly the responsibility of procuring entities—conflicts with its function in oversight. At all levels of government, procuring entities are poorly organized. There

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1 Information based on an amendment to the Constitution signed by the president on November 9, 2006. A subsequent amendment was passed in December 2006. It is not clear whether this provision was affected by that amendment.
is a general lack of qualified procurement professionals; and as a result, poor practice prevails from procurement planning to contract implementation.

20. **Significant weakness in the system need to be addressed urgently.** Information provided in tender notices is too often incorrect and misleading. Bidding documents are often unavailable to interested bidders. Technical specification quality is poor. Bid preparation time is too short. Contract award decisions are frequently based solely on the lowest price, not the lowest evaluated price. Tenders are sometimes cancelled without notice or explanation. Contract management practices are poor. Contracts are sometimes terminated without justification. The complaint resolution mechanism appears to lack objectivity and transparency. Overall, it is hardly surprising that providers of goods, works, and services express general distrust of the system.

21. **Procurement should begin with planning; however, budget formulation currently consists of little more than a list of items with estimated costs for budgeting.** There is no multiyear planning. After a national budget is approved, adequate procurement plans are neither prepared nor made public, which would help providers to adequately prepare responses to tenders. Procuring entities receive funds late in the fiscal year, leaving insufficient time to conduct procurement efficiently and economically.

22. **On January 9, 2007, the prime minister issued a resolution to reinforce adherence to the PPL.** It is clear that the Government now needs to take even stronger measures to translate the legislative mandate into results.

**Benchmarking against international standards**

23. **The World Bank team and SAPPMR staff jointly analyzed the Kyrgyz public procurement system.** The system was benchmarked against international standards as described in “Methodology for Assessment of National Procurement Systems Based on Indicators from OECD-DAC/World Bank Round, dated July 17, 2007.” The OECD/DAC methodology is based on four pillars—legislative and regulatory framework (I); institutional framework and management capacity (II); procurement operations and market practices (III); and integrity and transparency of the public procurement system (IV). Each pillar includes several baseline indicators (BLIs) and subindicators that describe formal and functional features of the system. A score of 0 to 3 is assigned to each subindicator and then aggregated in a single score for the indicator. A zero indicates failure to meet the standard. A score of 1 indicates that substantial work is needed. A score of 2 shows less-than-full achievement, with need for improvement. A score of 3 indicates that the standard was fully achieved.

24. **Figure 1 is a graphic that summarizes results from the benchmarking.** The four points of each diamond represent the four pillars (see previous paragraph). The area encompassed within the black diamond represents an “ideal” system that would

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2 This methodology also includes compliance/performance indicators (CPIs), which require monitoring data to determine compliance with the formal system. CPIs were not used in this assessment because of the lack of data.
theoretically conform perfectly to international standards as defined by OECD–DAC definitions and methodology. The smaller red diamond (within the black diamond) shows the Kyrgyz public procurement system compared to the ideal system.

Figure 1. Kyrgyz Procurement System Benchmarked Against International Standards (OECD–DAC Methodology)

25. As shown in the figure, the points of the diamond are determined by the composite scores for each of the four pillars transferred to the x and y axes. The highest Kyrgyz composite score is 2.1, representing the legislative and regulatory framework axis (Pillar I). In other words, according to the BLI assessment, the laws and regulations in Kyrgyz Republic basically meet an acceptable international standard. By contrast, in institutional and management capacity (Pillar II), the average score is 1.0. This means that institutional arrangements necessary to implement the legislation have not evolved accordingly. In procurement operations and market practices (Pillar III), the average score is 0.7. This reflects a strong need to initiate partnerships between the public and private sectors to strengthen existing external controls, to establish internal controls, and to implement the anticorruption program in an effective manner. In the integrity of public procurement (Pillar IV), the average score is 1.2. This means that integrity and transparency needs substantial strengthening, not only internal and external controls of public procurement but also measures to implement an anticorruption program in public procurement.

26. Annex 2 summarizes the main, prioritized recommendations of this report, based on results from the benchmarking. Some recommendations include: preparing a detailed implementation regulation; providing adequate staffing resources to the
SAPPMR and helping procuring entities organize themselves to carry out procurement economically and efficiently in compliance with the PPL; and strengthening the National Procurement Training Center and making it sustainable by providing budgetary resources for training. There is also need to improve the budget processes so that procuring entities receive timely allocations before the end of the fiscal year.

27. **In addition, a mechanism is needed to collect, maintain, and disseminate procurement data.** The 2002 CPAR also included this recommendation. It is hoped that this recommendation will now be implemented. There is also need to improve bidders’ trust in the system by improving the complaint resolution mechanism, the quality of tender documents, technical specifications, and the accuracy of the information in tender and contract award notices. Finally, the integrity and transparency of the public procurement system should also be improved by better alignment the PPL with anticorruption legislation, as well as increased training in public procurement to strengthen internal and external controls.
1. OVERVIEW OF PUBLIC FINANCIAL MANAGEMENT IN THE KYRGYZ REPUBLIC

Country Economic Context

1.1. The Kyrgyz Republic remains one of the poorest countries of the Former Soviet Union (FSU), with GDP per capita of US$540. Following the collapse of the Soviet Union in 1991, the Kyrgyz Republic underwent a severe economic crisis caused by loss of transfers from the Union budget of about 13 percent of GDP and disruption of economic links with other former Soviet republics.

1.2. The Kyrgyz Republic began market-based reforms in the early 1990s. Together with a benign external environment, these reforms led to an economic recovery during 1996–99, when annual real GDP growth averaged 5.5 percent (faster than most CIS countries, whose average was 3.1 percent). After the Russian financial crisis in 1998, growth slowed to 2.9 percent in 1998–99. The external current account deficit widened to 23 percent of GDP in 1998, exposing the economy’s vulnerability to external shocks.

1.3. Fiscal laxity in the 1990s, exacerbated by poor debt management and the shock from the 1998 Russian crisis, increased external debt. This was compounded by the willingness of the IFIs to finance imbalances to protect the social fabric of a country considered a rapid reformer among CIS countries. In addition, overly optimistic forecasts of growth undermined debt repayment capacity. As a result, external debt rose from about a third of GDP in 1995 to more than 100 percent of GDP by the early 2000s. Tighter fiscal management in recent years has reduced debt to about 70 percent of GDP. During 2000–05, the country achieved macroeconomic stability; and prompted by growing awareness of the debt overhang, authorities stabilized the debt ratios through fiscal consolidation. With enhanced coordination among the IFIs, the fiscal deficit was reduced from 12 percent of GDP in 1999 to 3.1 percent of GDP in 2006.

PFM Scenario

1.4. Reforms to public expenditure management began in the mid-1990s, and formed an important element of the National Poverty Reduction Strategy (NPRS) of 1996–2005. The foundations of public expenditure management were subsequently introduced, including a legal framework, budget management procedures, and a treasury system. NPRS recognized PFM as a pillar of poverty reduction and economic growth. Donors have supported these reforms through bilateral technical assistance and implementation of policy actions in budget support lending operations (such as Governance Sector Adjustment Credit (GSAC)). Donors have also undertaken several diagnostic studies of the country’s PFM framework. These studies have helped to informed the reform agenda. They have resulted in implementing actions such as revising the Law of the Chamber of Accounts (COA) and enactment of a new Public Procurement
Law (PPL). In the Country Development Strategy (CDS) of 2006–10, authorities recognize the persistence in problems in PFM and that improvement is essential for poverty reduction and economic growth. The authorities have recently begun implementing an action plan supported by all donors, and they have adopted the strengthened approach to PFM reform. The PFM Action Plan of June 2006 was prepared by the Ministry of Economy and Finance in collaboration with donors. The plan is a systematic approach to define major (albeit feasible) reforms based on analyses such as the Country Financial Accountability Assessment (CFAA), Country Procurement Assessment Report (CPAR), Programmatic Expenditure Review (PPER), Public Expenditure and Accountability (PEFA), and various technical notes on budget preparation and execution.

1.5. **Progress has been mixed after nearly a year of implementation.** Progress has occurred in some areas but has been slow in others because of poor management of reform, lack of clear champions, lack of qualified staff, and inadequate technical capacity in reform areas. There is consensus that future Bank ESW should prepare strategic technical notes in conjunction with the authorities, including technical assistance to complement the implementation. The Bank makes use of several tools for providing PFM assistance, including the PPER, which together with other donors continues to help authorities implement priority reforms in the PFM action plan. In addition, the PPER is also supporting capacity building in partnership with the Swedish International Development Cooperation Agency (SIDA), SECO, and DFID, as well as technical notes with recommendations.

**Rationale for the CFAU**

1.6. **The most recent analysis of public procurement was the Country Procurement Assessment Report (CPAR) in 2002.** The Country Financial Accountability Assessment (CFAA) carried out in 2003 and published in 2004. A Public Expenditure Review (PER) was finalized in 2004. In early 2006, the Public Expenditure and Financial Management (PEFA) Assessment was finalized. These reports highlighted strengths, weaknesses, and recommendations for strengthening PFM, including procurement. Some of these recommendations have been implemented; others have not. The Bank, the Government, and other partners needed to examine subsequent developments, identify reforms that have been implemented, and devise a roadmap for implementing those that remain. This report updates the analytical knowledge and technical assistance to authorities in accounting and reporting, public internal financial control (PIFC) framework, external audit, and procurement.

1.7. **The PEFA assessment (2006) did not reach conclusions in the areas of salary and nonsalary expenditures or timeliness and regularity of accounts reconciliation.** The PEFA assessment covered only internal controls in the Treasury, not internal control in the public sector as a whole. Moreover, post-PEFA developments in external audit and

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3 Now Ministry of Finance, after reorganization of the Government

4 SECO – Swiss State Secretariat for Economic Affairs
internal audit needed to be updated. In this context, the present CFAU examines the impact of changed circumstances such as the new Constitution and institutional changes in the government. It reviews the PFM legal and regulatory framework to identify strengths and weaknesses and makes recommendations for improvements.

1.8. **The CFAA and other PFM diagnostics provided useful input to the PEFA assessment that was carried out in late 2005.** The PEFA assessment also benefited from the first stage of the Programmatic Public Expenditure Review (PPER), carried out by the World Bank in 2005, which focused on key elements of the PFM framework—budget formulation and execution processes, and monitoring and evaluation. PEFA findings provide a framework for decisions on the use of country systems and procedures. They provide an understanding of the overall PFM architecture to enable development partners to design capacity development activities in close collaboration with the Government. The PEFA assessment also benefited from the Institutional Fiduciary Assessment (IFA) of the health sector in 2005 under the National Health Reform Program—Manas Taalimi. The IFA focused on the capacity and risks associated with elements of public financial management in the health sector. It made recommendations now being implemented for capacity building and risk mitigation measures.

1.9. **Although the government has undertaken several reforms in the past few years, challenges remain and new developments affect the PFM.** The CFAU provides the Bank, other donors, and the Government with an updated understanding of the PFM framework, including fiduciary risks in general and risks related to donor development assistance in particular. The CFAU identifies progress made since earlier diagnostic assessments (CFAA, CPAR, PEFA, IFA), and provides tools to help the government prioritize actions to build capacity for public expenditure risk management. The present fiduciary update will help development partner agencies and the government reach a common understanding on the remaining or emerging PFM reform issues and how their resolution can assist in attaining agreed upon development objectives.

1.10. **The CFAU also creates a basis for sustained dialogue with the Government on PFM and procurement reforms aimed at more efficient and effective use of public sector resources.** The CFAU focuses on reviewing development of the action plan initiated by the government as part of its strengthened approach to PFM reform, but with emphasis on: (a) internal control and internal audit; (b) accounting and financial reporting; and (c) external audit. The CFAU also involves an in-depth assessment of the national procurement system using OECD–DAC/World Bank methodology, which compares actual practice against international standards. It provides information to monitor performance while identifying weaknesses in current systems and procedures. The CFAU informs development of possible fiduciary risk mitigation and capacity building measures that, if successfully implemented, assure authorities that funds will be properly used. It provides the basis for more flexible management of the annual budget. These measures will enable the World Bank and other development partners to make decisions about relying on the country’s PFM systems and procedures in managing

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development assistance.

1.11. Taking account of the findings of diagnostic studies (including the PEFA assessment), the CFAU focuses on elements of the PFM system that directly affect the use of country systems. These include internal control and internal audit, accounting and reporting, external audit and procurement. The CFAU examines current strengths and weaknesses in the PFM framework and focuses on fiduciary risks in the use of public resources due to the identified weaknesses, as highlighted in the PEFA assessment and other studies. Weaknesses include weak internal controls that are compounded by the absence of a well-developed internal audit function, weak external audit, and weak public procurement capacity. The CFAU assesses progress made in implementing some recommendations of the CFAA and CPAR to address the weaknesses.
2. ACCOUNTING AND REPORTING

2.1. **Government accounting in the Kyrgyz Republic is performed at two levels.** The first is by line ministries, using a hybrid accrual-based approach for financial accounting. The second is by Treasury, using a cash-based approach for budget accounting. Line ministries (spending units) following the hybrid accrual basis record liabilities as incurred but record revenues only when received. Line ministries maintain their own accounting records in the prescribed formats using a double entry system. The basic goal of accounting in sectoral ministries is to keep track of expenditures relative to the allocated appropriations, although this duplicates accounting done at the Treasury.

2.2. **The goals and principles of accounting and reporting in national budget institutions (that is, ministries) are set forth in “Instruction on Accounting in National Budget Institutions” (No. 3/3, February 5, 2001).** The procedure of accounting in Treasury is reflected in normative acts that regulate treasury activities. In other words, duplication of accounting by line ministries and Treasury is not based upon the legislation. Duplication would seem to contradict the goals and functional duties of every participant of the budgetary process. However, there is ongoing verification between the Treasury and national budget institutions on Open Credits and Cash Expenditures.

**Key Issues Identified in Previous Diagnostic Reports**

2.3. **The 2004 Country Financial Accountability Assessment (CFAA) identified a number of weaknesses in public sector accounting and reporting.** It noted that the financial reporting system needed a major overhaul. These weaknesses are discussed in the following paragraphs.

2.4. **There are no consolidated financial statements.** Although line ministries prepare accrual-based financial statements and submit them to MOF, consolidated financial statements for the government as a whole are not prepared. Legislation requires only that a report on budget execution—comparing cash spent and received against the budget, together with an explanatory note—be submitted to the President and Parliament. The cash-based statements prepared by Treasury were used for cash management purposes and for presentation to Parliament. There was no consolidated reconciliation of the accrual-based financial reports and cash-based Treasury reports, which would have ensured accuracy of the consolidated reports to Parliament. Financial reports were rarely used for planning or management.

2.5. **Budget institutions lack financial management skills.** Budget institutions spend substantial time producing financial reports and statements, but there is no evidence that these reports are actually used by department management. This is despite the fact that the point of an accrual-based accounting plan was to facilitate financial management,
particularly of liabilities. The Central Treasury, which received consolidated statements from line ministries, did not analyze these statements, though they contained information on liabilities that could be useful in cash planning. This was attributed to lack of financial management skills at the departmental management level, and to the fact that the budget execution process was focused on the availability of cash from Treasury. Managers were constantly preoccupied with the availability of funds rather than focusing on broader financial management issues.

2.6. **There are delays in MOF submission of budget execution reports.** The Law on Budget places responsibility for preparing a report on budget execution on the MOF. The report on budget execution together with an explanatory note is to be submitted to the President and Parliament no later than May 15 of the year following the budget year. There were delays in meeting this deadline, sometimes of a month. Although the report has detailed information on the budget (amended versus actual) for both republican and local budgets, as well as for special means, the explanatory notes did not have information on arrears accumulated during the year. The report also did not include information on guarantees issued or invoked during the year.

2.7. **Accounting standards and a chart of accounts were deficient.** The Accounting Methodology Department in the MOF prepared comprehensive regulations ("Regulation on Accounting by Budget Institutions," February 2001). The regulations contained formats of registers and supporting documents, as well as instructions for conducting accounting in a budget institution. The regulations also included a chart of accounts. However, the chart of accounts had numerous deficiencies, such as combining debtors and creditors in one account code, and merging payments and liabilities under the same group. Regulations were incomplete in some respects, as they did not include formats of required reports. Budget institutions continued to be guided by outdated instructions from 1994. The regulations provided no guidance on how to account for settlements and offsets.

2.8. **There is a lack of trained accountants to manage accounting in budget institutions.** There are about 3,000 budget institutions, many without trained accountants. The Law on Budget does not require budget institutions to establish finance and accounting units headed by a finance officer or accountant. The "Regulation on Accounting in Budget Institutions" (February 2001) specifies that heads of departments are to maintain adequate accounting functions. In some institutions—for example, the central office of the Ministry of Agriculture and Water Resources—accounting was handled by non accountants. Some institutions had experienced bookkeepers who lacked skills in management accounting and reporting. There was a lack of understanding of financial management on the part of managers, and there was no demand for management accounting reports.

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6 This information was contained in the CFAA report conducted in 2002 and completed in 2004. The CFAU mission was informed by Treasury that the 2003, 2004, 2005, and 2006 annual reports were submitted to the Government and Parliament before the deadlines set in the legislation of the Kyrgyz Republic, that is, by May 15 of the year following the reporting year. However, these reports were submitted before being audited.
2.9. **Accounting at budget institutions was manual and labor intensive.** Accounting required the maintenance of several registers and production of numerous paper reports. As a result, the methodology had inherent weaknesses in accuracy and timeliness. There was no provision for management accounting data to provide managers with useful information on costing and performance accounting. Much staff time was spent on reconciling figures rather than producing useful information for control and decision making by management.

2.10. **Commitments were not recorded in Treasury ledgers.** Treasury maintained accounts on a cash basis and recorded transactions when money was received or a payment made on behalf of a budget institution. Regional Treasury offices maintained Treasury General Ledgers with individual accounts for each institution. Allocations received from the central Treasury office were recorded in each account to track actual payments vis-à-vis allocations. Treasury ledgers were maintained manually. This facilitated analysis and tabulation, but was unwieldy to maintain and prone to errors. Treasury is currently considering revised processes to implement commitment accounting.

**Developments and Reforms since 2004**

2.11. **The CFAA made several recommendations.** The recommendations were aimed at improving reliability and timeliness in financial reporting in particular and improving accounting and reporting systems in general. The recommendations included: (a) preparing consolidated financial statements for the government as a whole; (b) adopting International Public Sector Accounting Standards (IPSAS); (c) introducing uniform and integrated accounting and reporting software in budget institutions (using the same database as Treasury and adhering to the principle of “one transaction – one data entry – one record”); (d) training for line ministry accounting staff on accounting regulations and financial management concepts; and (e) training departmental managers in understanding and interpreting financial management reports. With the exception of a new budget classification and some progress toward adopting a new chart of accounts and public sector accounting standards, little progress has been made to implement these recommendations.

**Implementing the new budget classification**

2.12. **The PPER** noted that the government, with support from DFID and World Bank experts, developed and introduced a new budget classification consistent with GFS 2001 principles, starting from 2007. Initially the introduction was difficult for many organizations, as the final version of the classification was approved only a few days prior to its introduction, leaving no time for training. Nevertheless, in the first quarter of the year the Ministry of Finance, with support from DFID, organized training in the new classification for regional budget organizations.

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7 The Programmatic Public Expenditure Review (PPER) was conducted in parallel with the CFAU.
8 The Kyrgyz Republic adopted the new economic classification of revenues, expenditures, assets and liabilities and the new administrative classification under an Order dated January 11, 2007.
2.13. **Introducing the new budget classification was complicated.** MOF and Treasury requested budget organizations to submit budget requests at the lowest level of expenditure codes, thus increasing the volume of work at the local level as well as for the Central Treasury. The authorities regarded this as a temporary measure to ensure proper understanding of the new codes. From April 2007, budget requests are required in a summary form. Budget organizations have been allowed greater flexibility to manage resources within broad economic classifications. Only reporting is carried out at the more detailed level.

2.14. **In using the classification, it was recognized that minor modifications would be required.** The main issues in each dimension of the classification are described below.

(i) **Economic classification.** Budgetary institutions, regional treasuries, and the Central Treasury have started classifying transactions in accordance with the new economic classification from the start of the 2007 fiscal year. To facilitate implementing the new economic classification, the Ministry of Economy and Finance (now Ministry of Finance) took two important steps. First, it published the new classification and implementation guidelines. Second, it conducted extensive training for staff. However, MOF may need more training, not only for staff of budgetary institutions and treasuries but also for staff in local budgets.

(ii) **Administrative classification.** The new administrative classification uses a seven digit code. The first three digits identify the ministry or the agency and the last four identify the cost center of the respective ministry or agency. No problems have been encountered with this classification.

(iii) **Functional classification.** Functional classification has been finalized with help from DFID, and is awaiting approval by the Ministry of Justice. There is a need to link the functional classification with the new chart of accounts.

(iv) **Classifying funding sources.** Identifying funding sources, coding, and linking them with transactions are essential requirements of reform. These should be included the action plan for developing the new chart of accounts.

(v) **Program classification.** Developing program classification may take some time. Four or five digits are needed for program classification in the coding structure.

Work on all elements is underway in preparation for the new treasury system. DFID and the World Bank are jointly providing technical assistance.

**Analytical reports on consolidated transactions and cash operations**

2.15. **With World Bank support, Treasury has begun use the new budget classification to prepare all required summary reports.** Advice and technical support will continue to be provided to the Treasury to ensure that reports are prepared according to the provisions of GFS 2001. Under the PPER, such advice will be provided as assistance to Treasury in consolidating transactions relating to nonfinancial assets, financial assets, and liabilities.

**International accounting standards**
2.16. USAID has been helping authorities introduce cash-based International Accounting Standards in the public sector (IPSAS). However, responsibilities for accounting reform within MOF remain unclear. Following restructuring, a new division was created in MOF to be responsible for accounting and internal audit methodology. The Ministry of Finance and the Division of Accounting and Internal Audit Methodology need technical support to develop a roadmap for introducing the accounting standards in line with MOF Order No. 109 (on improvements in public sector accounting and reporting).

Chart of accounts
2.17. Technical support from DFID has enabled the government to prepare a draft chart of accounts, currently being considered by the Ministry of Finance. The ministry supports an integrated chart of accounts and budget classification. The head of Treasury appointed the deputy head to lead the chart of accounts reform effort together with the newly appointed head of the Division of Accounting and Internal Audit Methodology. It is hoped that collaboration will strengthen dialogue on the chart of accounts reform.

2.18. The new chart of accounts needs to be finalized urgently, given that MOF has invited tenders for procuring software to help modernize Treasury. An action plan was agreed with MOF to develop the structure of the chart of accounts by the first week of May 2007 and the detailed chart of accounts by August 31, 2007. Actions such as drafting detailed descriptions of each account, pilot testing, and developing financial reporting formats are to be completed by November–December 2007. It is also expected that technical support provided by DFID and the Bank will be used to form a group of experts to assist MOF in implementing the action plan.

Challenges and Next Steps in the Reform Agenda

2.19. With support from USAID, the government has been implementing a three-year public sector accounting program. This includes reviewing and updating of legislation and appropriate accounting standards. These activities are running parallel to modernizing Treasury operations under the GTAC program, which involves installing a computerized Treasury system with a major overhaul of Treasury business processes. Implementing appropriate accounting standards for government accounting should be an integral part of wider budget system reform and an overall transformation of public sector management. These activities have been delayed by organizational and staffing changes in the Ministry of Finance.

2.20. The transition to the new budget classification system and manual operation by Treasury is a major problem for budget execution reports. Regional Treasury departments have problems processing and entering the significantly larger volume of data. This has delayed the Treasury reports. Meanwhile, MOF must develop the skills to prepare and interpret and use the financial statements and to utilize the information in the line ministry accrual-based accounting reports. As suggested in the CFAA, departmental managers, including Treasury managers, need training to fully understand and interpret the data in the various financial reports. Such training will require financial support from
the development partner agencies.

2.21. **Budget organizations need revised accounting regulations.** These should reflect changes in public sector accounting, especially adoption of cash-based IPSAS. Regulations should specify procedures for higher-level consolidation, including instructions for netting out transfers and inter-office balances. The three-year USAID-financed program referred to in paragraph 2.19 provides for modernization and harmonization of the current accounting regulatory and methodological framework. Illustrative government financial statements have been prepared that are compliant with IPSAS cash requirements. Further, USAID assistance is helping to draft the Law on Accounting to reflect public sector requirements, including IPSAS. These efforts will require training for accountants in line ministries.

2.22. **There are still delays in submitting audited budget execution reports to the Parliament and to the President.** Reports for 2004 and 2005 were submitted in October 2005 and 2007 respectively, instead of the due date of May 25 of the following year. The budget execution report for 2006 was to be submitted for audit by May 15, 2007, with expected delay of up to three months before being submitted to the Parliament and President.

2.23. **Periodic training programs are necessary to develop skills to implement reforms in public finance management.** However, a more sustainable training policy should create a critical mass of trained public sector financial managers, including accountants with the skills to sustain reform. The Ministry of Finance should seek donor support to outsource public sector financial management and accounting training to experienced training organizations in the Kyrgyz Republic to ensure continuity of training and consistent quality standards. Initial donor support may be needed to engage a training coordinator in the Ministry of Finance, to investigate training needs, and to develop coordinated training plans. In the long term, however, the government would need to establish a center for training and retraining public officials if PFM.
3. SALARY AND NONSALARY EXPENDITURES

3.1. Salary expenditures are a significant fraction of line ministry budgets. In 2006, salaries represented about 40 percent of the MOF budget and 38 percent of the Ministry of Education (MOE) budget. The 2004 CFAA did not focus on salary expenditures at the line ministry level; however, it did take note of procedures for salary payments in Treasury offices and general issues related to personnel policy and recruitment procedures for managers. The CFAA reported that SAI audit reports did not show serious issues or weaknesses in the area of salary expenditures; however, it pointed to the need for computerization of payroll to strengthen internal control. The CFAA emphasized that salaries should be transferred directly to employees’ bank accounts rather than paid in cash.

Key Issues Identified in Previous Diagnostic Reports

3.2. The 2005 PEFA PFM assessment noted that personnel and payroll processes were both decentralized. Line ministries are responsible for remuneration levels within established guidelines. The PEFA assessment also noted that line ministries often increased or maintained personnel expenditures with funds allocated for vacant posts; or they concealed the actual number of staff in order to preserve the personnel budget, using the funds for disguised salary increases. These practices were facilitated by the decentralization of personnel and payroll functions. The lack of consistent payroll control raised questions as to the quality of the authorization and audit trail procedures.

Developments and Reforms since 2004

3.3. Current practice remains much the same. Each line ministry maintains personnel data and the staff list issued at the beginning of the year. Revisions can be made during the year—for example, the 2006 staff for the MOF Central Apparatus and Central Treasury (approved in July 2006) comprised 312 regular employees, 73 secretaries, and technical staff. The list does not include staff in the territorial offices or the Economic Development Fund and Precious Metals Division, totaling more than a 1,000 employees as of March 2007.

3.4. There are three types of remuneration. First, principal or basic salary is

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9 Data from the chief accountants of the Ministry of Finance (MOF) and Ministry of Education (MOE), April 2007.

10 It is noted that the Government approved the State Program of Action for 2003-08 on the introduction of non-cash payments, as well as on payment of salaries to employees of ministries, state committees, and administrative agencies through accounts in commercial banks. However, the existing banking infrastructure (including the network of ATMs and payment centers) is not sufficiently developed for a complete transition to payment of salaries through the banks. Further, the tariff policy of commercial banks for opening accounts, servicing, and sale of plastic cards requires additional funds from budget institutions. These factors have resulted into employee reluctance to have salaries transferred directly to their accounts electronically.
determined at the beginning of the year based on the staffing list established at the beginning of the year. The employee's salary is paid at a fixed rate every month for 12 months. Second, four monthly bonuses and two bonuses for holiday leave are provided. Altogether, employees receive 18 salary payments during a 12-month period. Salaries and bonuses are financed from the budget. Third, employees also receive ad hoc payments that can be effected at any time during the year. These are at the discretion of department heads. Ad hoc payments include performance pay, which can be as much as 50 percent of basic pay; and rank-based pay depending on an internal test and length of service, which can be as much as 40 percent of basic pay. Depending on availability of funds, department heads can vary the timing of monthly additional payments. Each department must submit an estimate and explanation of how bonuses are determined.

3.5. **In addition, there single bonuses (one-off payments).** These can be made to purchase foodstuffs in winter or as representation payments to certain employees (such as department heads). Ad hoc payments, bonuses, and allowances are usually financed from "savings," mainly from vacancies. Other sources of financing for ad hoc payments include special means, such as a Special Development Fund, which was created in MOF from 7 percent of repaid debts.

3.6. **Salary administration and payment differ from ministry to ministry.** In MOF, salaries are processed using a special program. The payroll accountant inputs data into the payroll system from the staffing list for fixed wages, and from decrees from the minister for bonuses and allowances. The personnel department provides the attendance list, including chits for staff on sick leave, who are not normally paid during leave. The chief accountant and the head of administrative affairs approve the payroll. About 90 percent of employees receive their salaries through transfers to their plastic card accounts; the rest, mainly secretaries and technical staff, are paid in cash. Employees paid in cash have to sign for their salaries at the end of the month. All employees receive monthly pay advice slips showing the composition of the monthly pay, deductions, and net amount payable.

3.7. **At the Ministry of Education (MOE), employees receive 18 salary payments during the 12-month period financed from the budget.** There are also bonuses and allowances. These are often financed from savings and special means, usually fees received for issuing certificates and diplomas, and sponsorship from donors. The Treasury controls all special means accounts. All payments are based on approved payroll from the MOE. The MOE makes an application that is signed by the chief accountant and the state secretary and submitted to Treasury for approval. The MOE does not have a payroll program; all payments are made in cash.

3.8. **Overall, controls over payroll administration are weak.** On the surface, processing and payment appear to be adequate; however, the underlying risks are significant. First, there is a pervasive incentive for line ministries to conceal the number of staff in order to maintain a steady level for the personnel budget. This creates a source of funds for disguised salary increases. Second, the determination of employee bonuses and allowances is arbitrary. Bonuses are not based on annual performance appraisals.
They are left loosely to the discretion of department heads and are based primarily on availability of funding. Thus, department heads have a strong incentive to overstate staffing lists at the beginning of the year so that they can realize “savings” from “unfilled vacancies.” This raises the temptation to keep ghost workers on the payroll. If line ministries declare positions vacant, they risk losing the related budgetary allocation.

3.9. **Controls over nonsalary expenditures are standard.** These are guided by “Instructions on Accounting Systems for Budget Organizations, No. 33” (February 2001). The starting point is for MOF to approve the line ministries’ expenditure estimates. This is followed by opening of credits upon approval of the budgetary orders submitted by each line ministry. Each line-ministry spending unit verifies invoices before forwarding them to Treasury for payment. The spending unit keeps records and prepares monthly reports on budget execution on a cash basis for reconciliation with Treasury. Spending units also prepare quarterly Financial Information Reports (Form 2), which are submitted to the line ministry head office. The reports are checked and approved by the concerned Treasury office before being sent to the head office. Similarly, a Report on Special Means (Form 4) is prepared, and then checked and approved by Treasury.

3.10. **Payments for goods and services are often made in advance of receipts.** In some cases, up to 100 percent of payments are made for goods not yet received. Treasury has recently intervened to reduce this practice. An instruction to MOE specified that no payments be made until goods are received (No. 36, April 17, 2006). Nevertheless, MOE still routinely provides for up to 40 percent advance payment with the balance paid upon receipt. Goods are normally received by personnel who are appointed by the minister and have no role in processing payments; so the risks of collusion are very real.

**Improvements and the Ongoing Reform Agenda**

**Procurement**

3.11. **Procurement controls need to be strengthened to ensure compliance with public procurement law and regulations**—for example, Treasury instructions on overpayments to ensure that goods are received. The practice of advance payments should be discouraged. When allowed, safeguards should be in place to ensure that goods are eventually received—for example, by requiring bank guarantees. Controls should be strengthened for expenditures below the threshold of KGS 100,000 (approximately US$38,000), including an effective approval process and mechanisms to detect contract splitting to evade scrutiny by tender commissions.

3.12. **It is common for accounting staff in line ministries (for example, the Ministry of Education) to handle some procurement.** This creates a conflict of interest and can weaken internal control. The person buying goods should have no role in payments. Line ministries should establish separate procurement units not responsible to accounting and reporting units.

**Human resources, including compensation**

3.13. **In parallel with the CFAU, the Bank-led PPER looked into human resources**
(HR) reforms. These include changes to public sector compensation schemes, such as salary structures that are fully transparent and predictable. Reforms will target the localized and inefficient HR administration, where each ministry, no matter how small, incurs the expense of running competitive public recruitment and its own payroll administration. The PPER team suggested that these functions could be more efficiently managed on a larger, probably service-wide, scale. Payroll administration should eventually be centrally managed for the civil service as a whole, which would strengthen financial control and save money. It is hoped that this objective could be realized in the context of modernizing Treasury and introducing a human resources management information system (HRMIS) to the civil service. Payroll also needs to be computerized. The MOF should seek donor support to implement such a system.

3.14. The MOF wants to develop an organization based on operational requirements. Compensation would be job-based. Rates of pay would be competitive, including performance-related pay. A review of organizational roles in MOF would prepare the ground for detailed job descriptions based upon roles and responsibilities. Job evaluation and preparation of grades based upon new job groups could provide the foundation for a new pay and grading structure.

3.15. An approach oriented toward functional responsibilities might be excessively ambitious if applied to the entire civil service. Even under the most favorable of political circumstances, it would take time to implement. It is thus recommended that such an approach first be piloted by a single agency, most likely the Ministry of Finance. This would build upon related work to review the ministry’s business processes. The goal would be a unified civil service pay scale tied to job descriptions, thus eliminating multiple pay scales and simplifying payroll tracking. MOF is developing pilots in selected divisions to implement new performance management systems based upon earlier work under the PPER. These pilots aim at better, more transparent performance management systems. They use existing allowances to reward good performance.

3.16. The structure of bonus distribution requires urgent review. By law, quarterly bonuses should be justified by detailed assessment of staff performance; and personal monthly allowances are supposed to be performance-based. The current broad legislative criteria provide little concrete guidance to managers on the distribution of allowances. Disbursement of allowances varies by agency, with ample room for both managerial discretion and fraud. The pilot within MOF should rationalize allowances according to individual and departmental performance assessment. Four divisions have been selected to test the viability of the new system. DFID is supporting the preparation of clearer division functions, job specifications, and performance appraisals.
4. INTERNAL CONTROL AND INTERNAL AUDIT

4.1. As confirmed in various diagnostic assessments, Kyrgyzstan has neither the legal nor the institutional framework in place for effective internal control. The concept itself is not well understood within the country. Following a change in government, the recently reorganized Ministry of Finance established a Unit of Financial Control. Its exact functions are still evolving; however, the ministry has clearly set up a unit that will routinely carry out inspections in other budget organizations. This arrangement appears to be inconsistent with broader MOF attempts to create a modern framework for internal audit, as well as the ministry’s own decision to set up an internal audit methodology unit.

4.2. The future role and staffing level of the new unit has generated concern at the Chamber of Accounts (COA) of the Kyrgyz Republic. Established by the Law on Chamber of Accounts in 1996, COA performs the country’s external public audit. The chamber evolved from the State Financial Inspectorate, which was established in 1992, and became the Chamber of Control in 1995, before then becoming the Chamber of Accounts the following year. The law establishing the chamber was rewritten in August 2004. As the Supreme Audit Institution of the country, COA is particularly concerned with potential duplication of responsibilities—or even the perception among line ministries that COA and the new unit might be doing the same kind of external audit work.

4.3. The International Organization of Supreme Audit Institutions (NTOSAI) defines internal control as a tool for providing management with reasonable assurance that its objectives are being met. This definition implies that responsibility for internal controls rests with management. In the past, internal control was primarily equated with financial controls. The Committee of Sponsoring Organizations (COSO) framework has broadened this concept beyond hard controls (such as segregation of duties) to also include soft controls (such as competence and professionalism among employees). The newer concept also takes into account management philosophy and differences in operating style. According to COSO, “Internal control is broadly defined as a process, effected by management, designed to provide reasonable assurance regarding the achievement of objectives in the following three categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.”

4.4. The European Commission has created a state-of-the-art model of public

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11 This information was based on the CFAA. However, the Chamber of Accounts clarified that the State Finance Inspectorate functioned as a separate body until it was merged with the Chamber of Accounts in 2000.
12 See the International Organization of Supreme Audit Institutions web site at http://www.intosai.org/3_INTCOe.html.
internal financial control (PIFC). The PIFC model aims to ensure that transactions comply with principles of sound financial management, transparency, efficiency, effectiveness, and economy, as well as with relevant legislation and budget descriptions. The concepts of managerial accountability and independent internal audit are central to PIFC.

Issues Identified in Previous Diagnostic Reports


4.5. The CFAA (2004) considered budgetary, Treasury, accounting and reporting, procurement, and human resource controls; and it came to the following conclusions.

1. The overall internal control framework was weak. This was evidenced by instances of illegal use of funds and waste that were reported year after year by the external auditor (the Chamber of Accounts). Treasury controls at the central level were also found to be weak. Over-reporting of payments and under-reporting of collections by the agent banks were noted. The framework was further weakened by the absence of internal audit.

2. Clear legal requirements were absent for line ministries. A legal framework should define managerial accountability within an organization. The Law on Budget refers to the responsibility of managers and public officers for “maintenance of the budget funds” (Article 22); however, this does not go far enough. Explicit legal requirements would heighten line managers’ attention to internal control issues.

3. Normal procedures failed to detect and resolve instances of abuse and waste. This omission suggests an ineffective control regime overall.

4. The Chamber of Accounts audit reports reflected several instances of noncompliance with laws, as well as fraud and corruption across several ministries. A detailed risk assessment and an action plan would strengthen the framework. As stipulated under the COSO framework, soft controls are no less important than hard controls; so going beyond the usual questions related to safeguarding of public resources against fraud and waste, soft controls too (such as employee competence) needed to be part of the risk assessment.

5. Treasury controls focused on insignificant and relatively small payments. This left insufficient resources for monitoring large and vulnerable payments. Even without automation, Treasury staff did well at managing day-to-day transactions.

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14 The mission was informed by Treasury officials that this problem has been resolved by e-verification with agent banks on a daily basis, with reports drawn up on a monthly basis. Any balances in the transit account of the agent bank bank is transferred to the Treasury’s current account every day, and it gets zeroed as of the end of the day. This comments refers to the following point as well.
operations. However, little time was left for financial risk assessment, because most of their time was spent on clerical activities.\textsuperscript{15}

6. **Written rules are excessive in some areas and incomplete in others.** This leads to an incomprehensible system of internal controls. For example, Treasury had detailed how payment requests received from the budget institutions were to be verified. However, rules were incomplete as to how they would be reconciled at the central Treasury level.

7. **The amounts reimbursed to the agent banks were not reconciled with Treasury records.** This posed several risks, including possible over-reporting of payments by the paying bank to utilize the float during the month. Although reconciliation was done daily at the rayon level, this was not extended at the consolidated level. As a result, differences emerged between the amount requested by the head office of the agent bank(s) and the total of payment requests by all the Treasury offices. Similar risk existed in the revenue collection mechanism. The tax revenues were collected by specified commercial banks. The commercial banks were then required to transfer the collections on a daily basis to the agent banks. However, there were no checks and balances to verify that the banks actually transferred the collections on a timely basis.

**Country Procurement Assessment Report**

4.6. **The CPARI\textsuperscript{16} was prepared concurrently with the CFAA.** Key findings included the following:

1. **The Public Procurement Law had not yet been translated into sound practices.** The PPL is comprehensive; however, practice is marked by weak oversight, a lack of well-trained procurement officers, and excessive authority and discretionary powers by the “tender committees.” Over time, procuring entities have established undesirable practices, which seriously affected bidders’ trust in the system. The report further observed that the State Agency on Public Procurement and Materials Reserve (SAPPMR), which was supposed to provide oversight over the decentralized procurement function, was itself becoming involved in the procurement process. The cost was lost objectivity and independence, essential requirements for an oversight body.

2. **No civil service reforms ensured transparency in appointments of senior positions.** Appointments of department heads were not based on set criteria such as competitive examinations. Understanding of modern management practices and ability to understand, interpret, and use management accounting reports (for example, analysis of service costs, outstanding liabilities, or commitments) were

\textsuperscript{15} Treasury presented the mission with written verification that it now conducts at least some risk analysis through, among other means, cash forecasting, preliminary budgetary deficiency analysis, financial gaps analysis between the resources and revenue (on monthly and quarterly basis).

\textsuperscript{16} For detailed discussion on procurement assessment, see Country Procurement Assessment Report (CPAR), which was prepared concurrently.
not central requirements to the selection of department managers.

3. Except for a small MOF unit, no internal audit carried out compliance tests for Treasury transactions or for the Ministry of Labor and Social Protection. Under constant pressure to maintain budget discipline, line managers developed alternative mechanisms for obtaining assurance of financial integrity. In the absence of internal audit staff, line managers frequently asked the technical or accounting staff to perform rudimentary internal audit functions. Absence of internal audit further compounded the already weak framework.

Developments and Reforms since 2004

4.7. The CFAA made a number of recommendations. These included the following:

1. Enact the Law on Public Sector Internal Audit.
2. Build capacity by establishing a modern internal audit function and provide training.
3. Establish effective internal audit structures in the line ministries and prepare rules and methodology for conducting internal audits in the public sector.
4. Create a secure, centralized database of employees to strengthen internal controls in payroll processing.
5. Automate payroll systems and treasury operations.
6. Strengthen Treasury controls. Among other measures, strengthen the cash management function; reconcile consolidated district treasury payment requests daily with the reimbursement made by the National Bank of the Kyrgyz Republic (NBKR) to the agent banks.

4.8. Progress has been made in some of these areas—in particular, in operational matters such as Treasury controls. Some recommendations were of a longer-term nature and may require significant investment in resources. Other recommendations are being addressed gradually within the overall PFM reform agenda.

Internal audit function

4.9. Relatively little progress has been made for an internal audit framework. The structure of the MOF has lately been revised, with a new division in charge of financial reporting and internal audit methodology. The new division is still grappling with the definition of its functions. It will take some time before it is fully staffed with people who can engage effectively in ongoing reform dialogue. There is also a new Division of Financial Control. Its functions and its relationship to the new division of financial reporting and internal audit methodology have not yet been precisely defined. Until

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17 In subsequent written submission, MOF clarified that the functions of the two divisions were defined in a government resolution on April 9, 2007. First, the Division on Methodology of Financial Reporting and Internal Control is to be responsible for establishment and improvement of the legislative base and methodology basis for accounting, financial reporting, and internal audit. Second, the Audit Methodology
recently, there was no clear counterpart to work with the development partners in designing a PIFC strategy; and as a result, this important part of the reform process was delayed.

4.10. **Internal audit initiatives have been introduced at both central (MOF) and sector level.** Although not driven by a deliberate strategy, a number of line ministries have created internal audit units. Other initiatives, such as a decentralized internal audit strategy, have been undertaken in direct response to the CFAA recommendations.

4.11. **Progress in the Ministry of Finance has been relatively limited.** Two new divisions—Financial Control, and Financial Reporting and Internal Audit Methodology—were created within a restructured Ministry of Finance. However, their functions are not yet fully defined. Some officials have had difficulty in differentiating between the roles of a financial control department, internal audit, and the Chamber of Accounts. Responsibility for developing an internal control framework should be vested in the new Division of Financial Reporting and Internal Audit Methodology; and internal audit should have been elevated to a separate division, reflecting its centrality in the structure of an internal audit framework.

**Law on internal audit**

4.12. **The Law on Internal Audit was drafted with support from DFID experts.** The new law should provide a legal basis for internal audit. The authorities have a clear plan for eventual enactment of the draft law. They presented this plan for comment to the ministries before submission for formal approval by the Jorgorku Kenesh (Parliament). This process is by no means a formality, as the law may not be entirely welcome. For example, the Chamber of Accounts not only raised issues with the draft, it submitted an alternative. Some issues raised by the Chamber of Accounts reflect evident misunderstanding, particularly on how internal audit is defined in relation to the Ministry of Finance. The Chamber believes, first, that internal audit should be subordinate and subject to its supervision, including routine approval of internal audit programs and plans; and second, that the chamber—not the central coordinating agency, as proposed under the draft law—should coordinate public sector internal audit. Third, the Chamber also believes (wrongly) that such a coordinating body would be the de facto external auditor to other line ministries, especially those that do not have internal audit units. Development partner will need to work closely with all the stakeholders to minimize the possible negative impact of the misunderstanding.

**Internal audit function in budget organizations**

4.13. **Despite the legal void, internal audit units have been established in several line ministries and agencies.** These include the Ministry of Agriculture, Water Resources and Processing Industry, Ministry of Health, and the Mandatory Health Insurance Fund, Ministry of Defense, Ministry of Emergency Situations, Ministry of Labor and Social Protection, and the Social Fund. Some of these internal audit functions were set up to...
comply with donor requirements for a stronger fiduciary environment. However, the trend signifies greater awareness of internal audit in controlling spending at every level.

4.14. Improved collaboration between donors and the government aimed at greater awareness of the internal audit concept. This awareness reflects workshops and training events to improve the technical skills for internal audit and to create better understanding, as well generally changing the mindset of managers. Under the DFID PFM program, training has been provided to internal audit staff of the Ministry of Finance and to line ministries. Pilot internal audits have been undertaken as on-the-job training for selected ministries and agencies. A program has been developed for further joint pilot audits. Such pilot audits would also help distinguish between the role of internal audit and external audit by the Chamber of Accounts. A draft internal audit manual has also been developed, and draft subsidiary regulations and auditing standards are nearing completion.

4.15. Despite this progress, much confusion remains over differences between control and audit, and differences between external and internal audit. This holds for the ministries as well as for COA. The chamber has yet to fully discard its past control-and-inspection mentality. Internal audit is viewed as duplicating its role. Confusion is exacerbated by the absence of a legal framework. This encourages COA personnel to largely ignore internal auditors in the line ministries, or to dictate to them the work they can undertake. In addition, the resurrection of a financial control function within MOF, notwithstanding on a small scale, has provided ample new ammunition for the COA’s argument that the ministry is seeking to duplicate its functions.18

Recommendations and Next Steps

4.16. In view of the uncertainties, it has been proposed that the government seek technical assistance from its development partners. This assistance would support the ongoing effort to establish basic elements of an effective internal audit function in the short-term, and to lay the foundations for a public internal financial control (PIFC) strategy in the medium to long-term. The Ministry of Finance recognizes that technical assistance will be required in several areas—strategy formulation and program development, improving the legislative and methodological basis for internal audit, training and certification of internal audit professionals, establishing institutions for training and retraining internal audit staff, and consideration of the internal audit function across the public sector as a whole. There are some indications that DFID might be willing to supporting internal audit in its planned renewal of the PFM program; and if so, the Government should tap this support. The Government should also approach partners such as the EU and the World Bank for the longer-term development of the PIFC

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18 In written submission following distribution of the draft report and request for comments, the Chamber of Accounts stated that its intention is not to subordinate the internal audit function under its direction. COA also reiterated its concern that internal audit by the Ministry of Finance and COA are, at present, duplicative. COA argues that the internal audit unit in the MOF should operate like internal audit units in other sectoral ministries, with MOF playing a coordinating role. COA argues that the coordinating role should be played by the Government (Office of the Prime Minister).
framework.

4.17. The new draft law needs to go forward. To avoid confusion caused by the parallel draft law submitted by the Chamber of Accounts, it is proposed that the Ministry of Finance and the Chamber of Accounts should hold an urgent roundtable, with the PFM Working Group participating. This process would clarify the misunderstanding of the draft law and should help to allay fears of possible overlap and duplication of functions.

4.18. The current and future role of the financial control unit within the Ministry of Finance needs to be clarified given that several line ministries have now established their own internal audit functions. This clarification should further allay suspicion, especially within the Chamber of Accounts, that such a unit will serve as a de facto external audit function in other ministries and agencies. In regard to the draft law, COA contends, first, that the internal audit function within the Ministry of Finance should be limited—essentially to reviewing activities within MOF, focusing mainly on Treasury operations; and second, that the functions of the Division of Financial Reporting and Internal Audit Methodology should be limited to formulation and coordination of policy guidelines, and development of standards and manuals for internal audit.

4.19. The definition of roles advocated by COA is supported by the current draft law on internal audit. However, creating separate and distinct Divisions of Financial Reporting and Internal Audit Methodology could help the two units to refocus on their core functions of financial reporting and internal audit, respectively. This would be consistent with the proposal in the draft law to create an authorized agency for internal audit. Although the draft law does not specify where the authorized agency would be located, it is envisaged that such an agency would also carry out internal audit in other line ministries as well as in agencies without their own internal audit units. Such an arrangement would require internal auditors from the authorized agency to be formally attached under the administrative responsibility of the head of the recipient ministry or agency.
5. EXTERNAL AUDIT

5.1. The Chamber of Accounts (COA) of the Kyrgyz Republic, established in 1996 by the Law on Chamber of Accounts, performs the country’s external public audit. The COA evolved from the State Financial Inspectorate, established in 1992, which in 1995 became the Chamber of Control before becoming the Chamber of Accounts the next year. The establishing law for the chamber was rewritten in August 2004.

Key Issues Identified in Previous Diagnostic Reports

5.2. The 2004 Country Financial Accountability Assessment (CFAA) made a number of observations about the external audit function of the Republic. These are summarized below.

5.3. The core functions of the Chamber of Accounts (COA) are not constitutionally mandated. The Constitution of the Kyrgyz Republic confines itself to specifying the responsibility of the Parliament with regard to audit, and it specifies that the President of the Republic is to appoint COA members. However, the roles and responsibilities of COA were defined statutorily in the 1996 Law on Chamber of Accounts, which defined the chamber as “the supreme body of state financial and economic control,” a clear indication that it was to be the Supreme Audit Institution (SAI) of the country.

5.4. There is a clear reporting relationship for the Chamber of Accounts. The establishing law of 2004 stated that the COA is accountable to the President and the Parliament, who are designated as the ultimate recipient of audit reports.

5.5. The law, however, did not define the meaning of audit. The word control was often used to indicate COA responsibilities. The law made COA responsible for formulating proposals to eliminate deviations from budgetary allocations in particular, and for improving the budget process in general. COA was not asked to certify year-end financial statements for the government as a whole, accounts of ministries, or other state organizations.

5.6. The Chamber of Accounts did not receive authority to conduct interim audits. The law authorized COA to “identify” the effectiveness and expediency of public spending. COA was granted broad auditing scope related to state funds transferred to

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19 This information was based on the CFAA (2004). However, the Chamber of Accounts subsequently clarified that the State Finance Inspectorate functioned as a separate body until it was merged with the Chamber of Accounts in 2000.

20 In its written response to draft of the present report, the COA clarified that, in addition to setting out responsibilities of the parliament and President with regard to appointment of members of the Chamber of Accounts, the Constitution also describes the functions of the Chamber of Accounts to include audit over execution of national and local budgets, extrabudgetary means, and use of state and municipal property (Section 4, Clause 80, Law on the Chamber of Accounts).
local governments, as well as entities in which the state had a financial stake. However, the COA was not allowed to review transactions for the current year: it could audit them only after year's end. Moreover, COA was not allowed to audit all financial statements of NBKR,\footnote{NBKR’s annual financial statements are audited by an international auditing firm.} except expenditures from budgetary resources during the year.

5.7. COA lacked the resources and skills to review draft budgets before presentation to Parliament. Although the Law on Budget authorized COA to “verify” the draft annual budget and submit a report on such verification to Parliament, differing views on this authority emerged. COA consequently desisted from such reviews. More importantly, COA also admitted a lack of resources and skills to effectively review budget assumptions and estimates.

5.8. The chairman and members of the chamber lacked security of tenure. COA had 12 members, six of whom were appointed by the two houses of Parliament, and six by the president. The president originally also appointed the chairman. The 2003 amendments to the Constitution changed the process to a presidential appointment of the chairman with the consent of Parliament. The chairman's term was fixed at five years, and the members served terms concurrent with those of Parliament. However, the appointment process was seen as largely political, and the president was empowered to dismiss a chairman before the chairman’s term expired if the president concluded that the chairman's job performance was unsatisfactory or the powers of the chairman had been abused. Chamber members also could be dismissed by their respective appointing authority under specified circumstances.

5.9. The Chamber of Accounts lacked complete independence from the executive. The president had the authority to approve COA structure, staffing, and employee compensation policies upon the recommendation of its chairman. Except for this, the law contained adequate provisions to ensure that COA had the functional and organizational independence to do its work objectively and effectively.

5.10. The law created negative financial incentives for COA operations. The chamber was allowed to retain 10 percent of fines and penalties that it levied as a resource to defray its expenses. This created a perverse incentive to maximize receipts rather than focus on the primary mission of audit.

5.11. The Law on Chamber of Accounts did not specify requirement on the adoption of audit standards. The chamber claimed to follow Kyrgyz audit standards; but not only were these at variance with international standards, their implementation was far from satisfactory. The COA approach was based on the examination of financial transactions, identification of financial discrepancies, and investigation of fraud. The audit focus was on compliance testing, with little attention to financial audits or internal control risk assessments. There was scant evidence that modern procedures and techniques, such as risk-based auditing, were being applied to the planning and prioritization of the chamber’s work. A considerable gap also existed in the institution’s knowledge and grasp
of modern international auditing practice.

5.12. COA auditors lacked the skills and experience to apply audit practices in accordance with international standards. Most staff members were well-seasoned in control and revision, but they had little exposure to modern auditing practices. They needed substantially more training and on-the-job experience, particularly in risk-based and financial auditing. The chamber had never received substantive technical assistance.

5.13. The COA did not have a training program covering audit standards, risk assessment and control, audit reports, quality control, or professional ethics. The CFAA noted that the chamber would need technical assistance in implementing such programs.

5.14. Clear provisions were lacking on COA preparation and submission of reports on annual budget execution statements. Neither the Law on Chamber of Accounts nor the Law on Basic Principles of Budget contained specific provisions on submission. The latter law contained only an indirect provision requiring Parliament to review the chamber report before approving the government’s report on execution of the budget. However, the COA did not report on the budget execution statements. Instead, it produced an annual report on its own activities, as required by the Law on Chamber of Accounts. The legislation therefore needed to be amended, specifically to require COA to provide an annual audit report on the financial statements as well as the report on its activities.

5.15. COA audit reports had significant deficiencies. They did not clearly highlight the exact nature of control weaknesses, major issues, or conclusions. They lacked executive summaries, making it difficult to discern what was essential within the vast amounts of detailed information. The reports also did not identify root causes of reported violations, nor describe control vulnerabilities or failures. The reports did not state the purpose, scope, or standards governing the auditing.

5.16. The 2006 Public Expenditure and Financial Accountability assessment reported that no audit standards were applied for transactions. Moreover, in the absence of financial statements, no audit of the government’s financial position could be undertaken. As a result, the question of audit standards for government accounts was deemed irrelevant.

Developments and Reforms since 2004

5.17. As noted in the PEFA (2006), the Chamber of Accounts remains largely an inspection and control unit. Basically, it carries out periodic checks to ensure compliance with existing regulations, including public procurement law. Many of the weak spots identified in the CFAA are still apparent—lack of skills and experience to apply modern audit techniques, deficiencies in audit reports, lack of appropriate standards

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to guide the audits, vulnerability of COA management, and insufficient independence from the executive. The only significant development is the August 2004 amendment to the Law on the Chamber of Accounts. The new legislation is a direct outgrowth of the CFAA recommendations, and it addresses most of the deficiencies of the previous law. The bill increased the number of auditors to 14 (seven appointed by Parliament and seven by the president). The law also removed the 10 percent provision, and it clearly defines the terms *audit* and *performance audit*. It provides for expressions of opinion on audited financial statements. However, the law does not require the Chamber of Accounts to follow INTOSAI standards, which are more applicable to the public sector. Instead, it simply cites the International Standards on Audit (ISA) as the standard of auditing (Article 44).

5.18. **Article 50 of the Law on the Chamber of Accounts specifically requires the chamber to audit financial statements, accounts, and other information of public and municipal enterprises, and to “issue an audit report.”** This is rather vague because the article does not refer to an audit opinion. However, this can be inferred from Article 1, which defines *audit* as “an examination of financial statements of an audit object to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with the requirements of the KR legislation.” Reference to the requirements of the legislation is, perhaps, a reflection that the country has not yet adopted appropriate accounting standards (this matter is dealt with under Accounting and Reporting).

5.19. **The law provides for greater financial independence of the Chamber of Accounts by requiring that its funding be approved directly by the Budget Committee of Parliament.** Despite such positive changes, however, COA’s ability to attract and retain qualified and skilled audit specialists will continue to be undermined by the generally low wages in the public sector.

5.20. **The law does not strengthen protection for the chairman of the chamber.** The chairman can be dismissed by the President for a number of reasons, or by a two thirds vote in Parliament. These provisions not in line with international best practice because they expose the chairman to potential political manipulation. In fact, there were three chairmen of the Chamber of Accounts between 2004 and 2007, a situation that sheds doubt on the ability of the chamber to carry through reforms in a sustainable fashion. The constitutional amendments of December 2006 further eroded the independence of the COA chairman by giving the president the power to hire and fire without reference to Parliament (effectively negating the 2003 confirmation process alluded to above).

5.21. **Despite some weaknesses, the new COA law provides a much-improved framework for external audit.** The performance of the Chamber of Accounts has not

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23 The Chamber of Accounts' written submission clarified that the Constitution provides that the President appoint the chairman of the chamber with prior approval of Parliament. That is as it should be. However, the mission did not find evidence that recent changes in the chairmanship received parliamentary approval. Besides, the President has the right to appoint and dismiss half of the audit staff without parliamentary approval.
improved however. Indeed, the chamber acknowledges that despite having one of the best legislative frameworks in the region, no significant shift has been made from the control and inspection approach. Lack of training and inexperience with modern auditing practices are cited as reasons. COA’s ability to provide audit opinion on the government’s financial statements is also hampered by the lack of government-wide financial statements. Although the law stipulates that such financial statements are to be prepared in accordance with International Public Sector Accounting Standards, the Kyrgyz Republic has yet to adopt IPSAS. These are issues that the government would need to address, possibly requiring technical assistance from donor agencies.

Challenges and Opportunities

5.22. Overall, the Chamber of Accounts still needs significant capacity building to absorb and implement applicable international audit standards and practices. It is time to transition from an “inspection and control” body to an external audit body capable of providing third-party assurance on public resource usage. Currently, no auditors or audit specialists with any recognized accounting or auditing qualifications are on staff, despite the requirement in the enabling law that a COA auditor should be an internationally certified accountant or auditor (Article 20).

5.23. Some capacity building programs have been arranged for COA. This includes a twinning arrangement with the UK National Audit Office (NAO) that is part of the Kyrgyz Health and Social Protection project, which uses a sectorwide approach (SWAp) to health care. Under this arrangement, COA, and NOA will jointly audit financial statements of the Health Program. The arrangement provides for significant capacity building, including development of audit methodology, manuals, and training. However, much more extensive training and capacity building will be required.

5.24. The World Bank has recently approved a grant from its Institutional Development Fund (IDF) for COA capacity building. This support will further reforms in public sector auditing beyond those envisaged under the Health SWAp. Previously, DFID supported training of COA audit specialists. Continuation of this support is essential because the chamber’s training needs are medium- to long-term. Development partners need to coordinate their support to ensure sustainable capacity development.

5.25. To make the chamber more effective, a specific legislative provision is needed that requires follow-up for matters arising from COA audits. Empowering a parliamentary committee to follow up on issues raised in audit reports is one possible remedy. Currently, the Chamber of Accounts may refer matters to the General Prosecutor’ Office when violations are uncovered.

5.26. It was noted that the chamber is still using instructions issued before its enabling law was amended. These instructions focus on examination of documents, compliance with the law and regulations, and budget execution. The instructions currently are being reviewed by NAO and are expected to be revised as part of the
capacity building support under the twinning arrangement. NAO and USAID will be assisting the COA with the development of appropriate audit methodology and manuals.

5.27. The COA has internally developed what are referred to as “Kyrgyz Standards of Audit.” These are currently being reviewed by the Council. USAID has provided some assistance during the past year, emphasizing international auditing standards. It is understood that the COA Council will be considering the adoption of INTOSAI standards during its meeting in late June 2007.

5.28. The Chamber of Accounts has a great opportunity to transform itself into an effective public sector audit institution. The twinning arrangement with the UK National Audit Office will provide hands-on experience in auditing financial statements using a methodology developed by NAO. Training in modern audit techniques and development of relevant audit manuals and guidelines will also be supported, as noted above. The IDF grant will supplement these efforts, focusing on strengthening the legal and institutional framework, further refinement of audit methodology and manuals, and training.
6. PUBLIC PROCUREMENT

6.1. This section contains four parts. The first discusses the current public procurement scenario in the country. The second deals with the reforms undertaken since the 2002 Country Procurement Assessment Report (CPAR). The third analyses the results of the benchmarking exercise conducted using the July 17, 2006, OECD-DAC/World Bank Methodology for Assessment of National Procurement Systems. The fourth discusses outstanding weaknesses of the system and makes recommendations for improvement.

6.2. The World Bank staff, in close collaboration with a counterpart government team, assessed the public procurement system and finalized the Country Procurement Assessment Report (CPAR) in December 2002. The 2002 CPAR included an action plan to improve the legislative framework through a revised public procurement law, a set of comprehensive implementation regulations, and other steps. This report takes stock of various developments since 2002 within the Public Financial Management Framework (PFM), thus providing a combined financial management and procurement update. The CFAU report covers other important elements of the PFM such as public sector accounting and reporting, internal controls and internal audit, and external audit. These elements are essential for a public procurement system that functions economically and efficiently, a goal which is integral to the PFM. This assessment provides a basis on which the Government of the Kyrgyz Republic (GOK) can develop a capacity-building plan to improve its procurement system. Donors can devise strategies for assisting the capacity development plan. This will help to mitigate risks in individual funding operations; and the country can better monitor system performance and the success of reform initiatives in improving outcomes.

6.3. This assessment has been prepared in close collaboration with a team established by the GOK. It incorporates analyses of the procurement legislation and feedback from various stakeholders in the procurement system, including government agencies, procuring entities, consultants, contractors, and suppliers, as well as representatives of civil society.

Overview of Public Procurement in the Kyrgyz Republic

6.4. The Government of the Kyrgyz Republic initiated public procurement reform in 1994 and enacted the first Public Procurement Law (PPL) in April 1997. Since then, the country's legislative framework for procurement has been under regular development. Following the 2002 CPAR recommendations, the Government drafted a new PPL, which was passed by the Jogorky Kenesh (Parliament) in April 2004 and took effect on May 24, 2007. This PPL not only implemented several CPAR recommendations, but was also substantially in line with international standards.

6.5. The PPL spells out the major principles of the public procurement process. It
identifies the parties to which PPL applies, defines the scope of authority of the State Agency on Public Procurement and Material Reserves (SAPPMR), and outlines the stages of purchasing procedure. The two main institutional categories under PPL jurisdiction are (a) state and other entities that use the state budget, and (b) state-owned enterprises (SOEs) that are majority owned by the government. Among the strong points of the PPL are the following:

- A decentralized procurement system in which all users of budgetary funds, central and local, are responsible for conducting their own procurement
- Adequate notification of bidding opportunities to suppliers and contractors
- A requirement that the SAPPMR provides technical assistance to procuring entities in their organization of procurement functions
- Clear provisions for selection of consulting services.

6.6. **The framework for implementing the public procurement reform falls on the SAPPMR.** SAPPMR has overall responsibility for developing procurement legislation and providing support and oversight to ensure procuring entities' compliance with the law. Procuring entities are responsible for the actual conduct of procurement, while external controls are exercised by the Chamber of Accounts (CA). Internal controls do not yet exist. The Treasury in the Ministry of Finance deals with contractual payments and is also responsible for verifying that a procuring entity has conducted procurement in compliance with the PPL. While a national public procurement implementation framework does exist, weak implementation of the PPL shows that there is much room for strengthening the process.

6.7. **The public procurement legislative framework provides a theoretically sound environment for competitive and transparent procurement.** This framework includes the PPL and a number of resolutions. However, implementation of the statutes by procuring entities is weak. Procuring entities at all levels of government are poorly organized and their personnel are trained inadequately to conduct procurement; the market is not fully functional; and the country's internal and external controls are either nonexistent or in their infancy at best. In a nutshell, implementation of the system is inefficient, resulting in uneconomic use of public funds for state procurement that cumulatively account for approximately 5 percent of annual GDP, as shown in Table 1.
Table 1. Public Procurement as a Share of GDP, 2004–06

<table>
<thead>
<tr>
<th>Year</th>
<th>Public procurement (US$ million)</th>
<th>GDP (in US$ million)</th>
<th>Ratio of public procurement expenditure to GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>97.2</td>
<td>2,239.9</td>
<td>4.34</td>
</tr>
<tr>
<td>2005</td>
<td>112.8</td>
<td>2,534.6</td>
<td>4.45</td>
</tr>
<tr>
<td>2006</td>
<td>158.4</td>
<td>2,924.0</td>
<td>5.42</td>
</tr>
</tbody>
</table>

Progress since the December 2002 CPAR

6.8. Since the December 2002 CPAR, several significant developments have occurred in the public procurement system of the Kyrgyz Republic. In the new PPL, the government implemented the majority of the Bank’s recommendations (extension of scope of application, creation of a separate chapter on procurement of consulting services, inclusion of additional definitions, provisions for financing the SAPPMR, among others). Many recommendations for organizational reform were also implemented, including separation of the procurement function from the State Materials Reserve Fund in the SAPPMR and reorganization of SAPPMR’s funding mechanism. As recommended, a government implementing resolution mandated procuring entities to send their complete procurement plans to the SAPPMR at the beginning of the budget year; the Public Procurement Bulletin is published twice weekly; and the amount of bid security is up to 3 percent maximum. One of the most important developments since the 2002 CPAR has been the establishment of the National Procurement Training Center (NPTC), supported by a grant from the Institutional Development Fund (IDF) of the World Bank. The NPTC, which belongs to the SAPPMR, is operational and has already trained over 1,500 public officials in conducting procurement under the PPL. It has also held several seminars for consulting firms, contractors, and suppliers. However, many other recommendations remain unimplemented (see Annex 1).

6.9. The GOK did not implement fully the recommendation for procurement capacity building. Dialogue within the government to establish procurement as a separate career stream in the civil service has not been initiated. The government also did not follow most of the CPAR recommendations on increasing accountability. No internal audit department has been established; findings on corruption in public procurement are not made public; the Chamber of Accounts annual reports are not published; and CA staff members do not receive adequate training in conducting procurement audits. It appears that several recommendations of the 2002 CPAR were not implemented, either because of the lack of resources or the absence of necessary pieces of legislation, or simply because the SAPPMR did not attach appropriate priority to them. It is strongly recommended that the GOK consider implementing these recommendations to make the
system more transparent, economic, and efficient.

6.10. **The PPL provides a clear legislative foundation for the SAPPMR.** The main functions of the SAPPMR are to (a) develop the legal framework for public procurement, (b) coordinate and regulate the activity of procuring entities in carrying out procurement, (c) monitor procuring entities' compliance with the PPL, (d) assist procuring entities in carrying out procurement through explanations of the PPL and provision of training to their personnel, (e) provide openness and transparency in procurement proceedings, and (f) review and adjudicate complaints. It appears, however, that the SAPPMR is more focused on reviewing procurement documents and evaluation reports—a role not mandated by any piece of legislation—than on its oversight and support roles. Consequently the procuring entities have yet, as stipulated in Article 13 of the PPL, to organize themselves to conduct procurement more effectively.

6.11. **The Prime Minister issued a regulation on January 9, 2007, to ensure that procuring entities implement the PPL.** In accordance with this resolution, the procuring entities shall (a) designate one of their departments to be responsible for procurement or create a procurement unit, and establish a separate tender commission for each tender, with the procurement unit and the tender commission strictly guided by the Regulations on the Procurement Unit and the Tender Commission; and (b) include in the procurement unit and the tender commission members who are trained and qualified. Only some procuring entities at the center have complied with this regulation while regional and district-level procuring entities have yet to do so.

6.12. **In response to the 2002 CPAR recommendation for resuming regular publication of the Public Procurement Bulletin (PPB), the CFAU team found that the PPB is published twice a week.** All procurement-related information, such as tender notices and contract awards, appear in the bulletin. However, the SAPPMR does not verify the information contained in these notices before publishing them in the PPB. Thus tender notices often allow very short bid preparation time; and incomplete or incorrect contract information is often included. Furthermore, contract award information is not published systematically. This tarnishes the transparency of the public procurement system.

**Assessment of the Procurement System, Using OECD-DAC/World Bank Indicators**

6.13. **In carrying out the benchmarking of the Kyrgyz public procurement system, the World Bank team worked closely with the State Agency on Public Procurement and Material Reserves.** It also sought views from other relevant government agencies and private sector firms representing civil works contractors, consulting firms, and suppliers of goods. The World Bank team conducted an in-depth review of the procurement legislative framework, including the PPL and several resolutions. The CFAU team carried out this assessment using the July 17, 2006, OECD-DAC/World Bank Methodology for Assessment of National Procurement Systems, which is based on four pillars, each of which includes several indicators.
6.14. The assessment provides the country with information to monitor the performance of its procurement system and the success of reform initiatives in improving performance. Identifying weak links in a current system also provides donors with information to better determine risks to the funds they provide to a partner country. This benchmarking has been conducted using the baseline indicators (BLIs) related to the formal and functional features of the existing system. The compliance/performance indicators (CPIs) that deal with monitoring to determine the level of compliance with the formal system have not been used because procurement data was lacking.

6.15. The BLIs present a snapshot comparison of the actual system with the international standards represented by the baseline indicators. They address four pillars: (a) the existing legal framework that regulates procurement in the country; (b) the institutional architecture of the system; (c) the operation of the system and competitiveness of the national market; and (d) procurement system integrity. Each pillar includes several indicators and subindicators that are scored using a range of 3 to 0. A score of 3 indicates full achievement of the stated standard; a score of 2 shows that the system exhibits less than full achievement and needs some improvements in the area being assessed; a score of 1 indicates areas where substantial work is needed for the system to meet the standard. A score of 0 shows failure to meet the proposed standard. The four pillars of the Kyrgyz public procurement system scored as follows:

| Pillar 1: Legislative/Regulatory Framework | 2.1 | Less than full achievement |
| Pillar 2: Institutional Arrangements      | 1.0 | Needs substantial improvements |
| Pillar 3: Procurement and Market Practices| 0.7 | Failure |
| Pillar 4: System Integrity and Transparency| 1.2 | Needs substantial improvements |

6.16. These scores show that progress has been made but much remains to be done. The legislative framework for procurement (Pillar I) has evolved toward achieving international standards in recent years. On the other hand, institutional arrangements (Pillar II) to implement the legislation have made little headway. In particular, the operations of the procurement system (Pillar III) do not inspire much trust among the providers of goods, works, and services in the evolving national procurement market. This indicates a strong need to initiate partnerships between the public and private sectors to strengthen existing external controls, to establish internal controls, and to implement the anticorruption program (Pillar IV) effectively. The following paragraphs include detailed discussions of the findings and recommendations for each Pillar.

**Pillar 1: Legislative and Regulatory Framework (Overall score: 2.1)**

6.17. Following the 2002 CPAR, the PPL of May 2004 provided a sound framework for public procurement. The government issued standard bidding documents, except for standard request for proposals for consulting services, which is being developed. The BLI assessment, confirms that the legislative framework generally meets international
standards. The findings and recommendations under the indicators for this pillar are as follows:

**Summary of Findings for Indicator 1 (Public procurement legislative and regulatory framework meets agreed standards and complies with obligations)**

- The legal framework provides for a sound public procurement system. The PPL of May 24, 2004, applies to all goods, works, and services procured with national budgetary funds and the funds of enterprises that are majority owned by the government. It provides for appropriate procurement methods and processes that promote transparency, fairness, and economy.
- The Ministry of Finance’s Order of October 18, 2001, requires that procuring entities seek and obtain for each procurement action a document (permit) from the SAPPMR certifying that it has complied with the PPL. This requirement not only adds to the procurement lead time but also cedes unnecessary discretion to the SAPPMR. This discretion opens the potential for misuse in the procurement process.
- The PPL has no provision on sanctions against procuring entities or staff for violating the PPL.

**Recommendations**

- Although the Ministry of Finance’s Order of October 18, 2001 has been amended to cancel the requirement of the SAPPMR’s involvement in the actual procurement process (See findings above and Footnote 4), the amended order is yet to be implemented effectively. The Ministry of Finance and the SAPPMR need to make concerted efforts to have all levels of government implement the changes.
- Include a separate provision on sanctions against procuring entities and their staff for violating PPL provisions.

**Summary of Findings for Indicator 2 (Implementing regulations and documentation)**

- Lack of a comprehensive implementation regulation and a manual.
- The PPL provides for bid prequalification but no criteria to determine when to apply it and no clear requirement that qualification should be assessed on a pass-or-fail basis.
- No guidance note exists on how to evaluate technical and financial proposals for consultant services.
- Standard Tender Documents exist and are of good quality. However, technical specifications prepared by procuring entities are of poor quality.
- The PPL requires that the contract should be awarded to the lowest evaluated bid, but there is no guidance regulation or note for procuring entities.

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24 Information on this subject received from the Treasury is as follows: “The order of the Ministry of Finance dated March 29, 2007, amended the “Instruction for the regional departments of the Treasury under the Ministry of Finance of the Kyrgyz Republic on the procedure for opening and keeping Treasury accounts on national budget expenditure transactions” to cancel the requirement for national budget institutions to submit the written permission from the public procurement agency to the Treasury.”
The SAPPMR’s involvement in the actual conduct of procurement does not allow it to objectively review and adjudicate bid complaints.

Recommendations

- Prepare a comprehensive implementation regulation and a manual with detailed explanations and clarifications of PPL provisions, including evaluation methodology for goods, works, and consultants.
- Include criteria in the implementation regulation that would enable potential bidders’ qualifications and experience to be assessed for prequalification on a pass-fail basis.
- Use clear and broad technical specifications and introduce the concepts of “substantial responsiveness” and “substantial equivalence,” with a view to procuring the best-quality goods, works, and services. The SAPPMR may have to develop model technical specifications, and design and deliver training to procuring entity staff in how to write broad and clear technical specifications.

Pillar II: Institutional framework and management capacity (Overall score: 1.0)

6.18. Pillar II looks at how the procurement system (defined by the legal and regulatory framework) operates in practice through existing institutions and management systems. The CFAU team found little improvement since the last CPAR. Benchmarking results and recommendations are provided below.

Summary of Findings for Indicator 3 (Public procurement system is mainstreamed and well integrated into the system of public sector governance)

- Procurement planning for budget formulation and budget execution is weak. The requirement of Article 13 of the PPL to prepare a procurement plan upon the approval of the Republic’s budget is not met. Multiyear procurement planning does not exist.
- The Treasury does not release the funds allocated to procuring entities in a timely manner. Frequently, these funds are available to procuring entities only a few weeks before the end of the fiscal year. As a result, procuring entities conduct uneconomic procurement using methods and procedures that lack transparency and do not foster optimal competition.
- Initiation of procurement actions without ensuring availability of funds is common, frequently leading to cancellation of tenders and even of contracts that have been awarded and signed. This seriously affects bidder confidence in the system. As a result, a growing number of bidders are deciding against doing business with the government.
- Procuring entities are not allowed to use funds saved through competitive procurement procedures, creating a disincentive for realizing any savings.

Recommendations

- The SAPPMR must work with the MOF to improve procurement planning from the beginning of budget formulation, as well as to enforce procuring entity...
compliance with Article 13 of the PPL. At the same time, the SAPPMR should prepare and disseminate to procuring entities detailed procurement plan formats listing all the essential information about every contract, such as the contract description, estimated value of the contract, procurement method, and the key procurement processing dates leading up to contract signature.

- The MOF should consider ways and means to make funds available to procuring entities in a timely manner, at least three months before the fiscal year closes.
- The MOF/SAPPMR must issue an order requiring all procuring entities to obtain written confirmation of funding availability before launching any tenders.
- The MOF should consider allowing procuring entities to use the savings derived from competitive procurement processes.

Summary of Findings for Indicator 4 (Country has a functional normative/regulatory body)
- The SAPPMR is inadequately staffed to fulfill its responsibilities for overseeing and supporting procurement by procuring entities in compliance with the PPL.
- The SAPPMR is involved in the actual conduct of procurement, which not only creates a conflict of interest with regard to its authority to review and adjudicate complaints but also seriously saps its already weak capacity to fulfill its original responsibilities discussed above.

Recommendations
- Consider strengthening the SAPPMR to enable it to fulfill its responsibilities in an effective manner. This is necessary for the agency to fulfill its oversight, support, and capacity-building roles.

Summary of Findings for Indicator 5 (Existence of institutional development capacity)
- The SAPPMR has the necessary means at its disposal (a Web site, the PPB, and government newspapers) to collect and disseminate information about the legal framework, tenders, and contract awards. However, the quality of the information published leaves ample room for improvement.
- No sustainable strategy and procedure exist for collection and maintenance of statistical data on procurement.
- The National Procurement Training Center of the SAPPMR provides training to public officials but is unable to meet all training needs. Furthermore, procuring entities do not receive budgetary allocations to pay the NPTC for staff training.
- No quality control standards exist to evaluate staff performance. The SAPPMR is yet to develop and implement a program for testing and certifying public officials as procurement professionals.

Recommendations
- The SAPPMR must review and verify the information contained in tender and contract-award notices to ensure that the information is accurate and in compliance with the PPL.
- The SAPPMR should develop a strategy and procedure for collection, maintenance, and dissemination of statistical data on procurement. This may
require the staff of the SAPPMR to study the procurement data collection system and its use in some advanced country such as Hungary or Slovakia, among others.

- The SAPPMR should strengthen the NPTC to meet the training needs of the country. To staff procuring entities with certified procurement officials, the agency should also introduce a testing and certification program.

**Pillar III: Procurement operations and market practices (Overall score: 0.7)**

6.19. **Pillar III involves the operational effectiveness and efficiency of the procurement system at the level of individual actions.** It considers the market as a means of judging the quality and effectiveness of the system after procurement procedures are put into practice. This pillar looks not at the legal and regulatory or institutional systems per se, but rather at how they operate. Findings from the benchmarking for this pillar follow below, with recommendations for improvement.

**Summary of Findings for Indicator 6 (Efficient country procurement operations and practices)**

- While the country has a sound procurement legislative framework, its implementation at all levels of government is weak. Few procuring entities have qualified procurement staff; some use a permanent tender committee, which is inconsistent with the PPL; and others assign this important task to one or two staff members who are already encumbered by the demands of other workloads.

**Recommendations**

- Implement the Prime Minister’s Resolution of January 9, 2007, which requires each procuring entity to establish a procurement section in one of its departments and to staff it with qualified procurement specialists.
- Strengthen the NPTC to meet the training needs of the country and to introduce a testing and certification program for procurement professionals.
- Allocate budgetary funds to procuring entities to meet the cost of staff procurement training.

**Summary of Findings for Indicator 7 (Functional public procurement market)**

- Public and private sector partnership is weak. NGOs play a very minor role in public procurement. Private sector institutions are still organizing. Most consulting firms, contractors, and suppliers have little confidence in the procurement system. This lack of confidence may be attributed to the following: incorrect and misleading publication of procurement opportunities; difficult access to bidding documents; poor quality of bidding documents, especially technical specifications; short bid preparation time for bidders; minutes of bid openings are not prepared properly and signed by all participants; unnecessary requirement to obtain a license from the SAPPMR before contracts can be awarded and signed; cancellation of tenders without reason; cancellation of contract awards without justification; frequent amendments to contracts during contract performance; and delayed contractual payments.
Recommendations

- The SAPPMR should develop mechanisms for partnership between the public and private sectors. NGOs should be encouraged to be more active in this partnership. To build private sector confidence in the public procurement system, the SAPMMR and procuring entities should eradicate undesirable procurement practices.

Summary of Findings for Indicator 8 (Provisions for contract administration and dispute resolution)

- While contract conditions include clauses on inspection, quality control, and other important matters, the contract administration procedures are generally weak, especially for civil works. Written contract administration procedures do not exist and staff is not provided with systematic training to fill the gap.

Recommendations

- To ensure that procuring entities administer contracts properly, it is imperative for the SAPPMR to prepare a simple manual on contract administration and for the NPTC to design and deliver a training program for procuring entities.

Pillar IV: Integrity and transparency of the public procurement system (Overall Score 1.2)

6.20. Pillar IV includes five indicators that a system must meet to operate with integrity. These controls support implementation in accordance with the legal and regulatory framework, as well as measures to address the potential for corruption. The pillar also covers important efforts to involve stakeholders in the control system.

Summary of Findings for Indicator 9 (Country has an effective control and audit system)

- While external audit exists in the form of the Chamber of Accounts, internal controls are nonexistent. The CA audits procurement regularly, but these audits are ineffective since the chamber’s staff is not properly trained in procurement processes. Furthermore, CA findings are not made public. It is not known whether recommendations are taken into account or properly enforced.

Recommendations

- Strengthen the capacity of the CA staff to audit public procurement. Make CA findings public and ensure that recommendations are implemented.

Summary of Findings for Indicator 10 (Appeals mechanism efficiency)

- Providers of goods, works, and services have little confidence in the appeals mechanism because they do not view the complaint review mechanism as
impartial, fair, and transparent. SAPPMR cannot effectively and objectively review and adjudicate complaints about a bidding process for which it also issues a document (permit) certifying that a procuring entity has complied with the provisions of the PPL.

**Recommendations**

- To increase bidder trust in the appeals mechanism, the SAPPMR must discontinue its direct involvement in the actual conduct of procurement—that is, review of evaluation reports, contracts, and other matters to issue the license required by the Treasury. The SAPPMR should also study appeal mechanism that are working efficiently in other countries (Slovakia, Hungary, and Poland, among others) and then adopt good practices. If necessary, it should revisit and amend the PPL. The complaint mechanism under the current PPL could be improved by expanding the parties able to file complaints and the subjects or grounds that are subject to complaint. The mechanism as designed only admits complaints from “participants” or actual bidders, effectively closing it to “interested parties” such as whistleblowers or potential bidders who did not participate because of irregularities or perceived irregularities. The grounds for complaint are also severely restricted. They should be expanded to include irregular selection of procurement method; the choice of award winner under Paragraph 4, Article 27; and the irregular granting of preferences under Article 3, if in contravention of the provisions of the PPL. Additionally, the practice of “debriefing” of bidders should be considered for inclusion in the new implementation regulations as well as in a future revision of the PPL. This will enhance transparency since the procuring entity has to articulate its justification for the award. It will also discourage the filing of frivolous complaints or those based on misunderstandings that can be easily clarified in a debriefing.

**Summary of Findings for Indicator 11 (Degree of access to information)**

- Procurement information is easily accessible but its quality is poor since SAPPMR does not systematically check the information submitted by procuring entities.

**Recommendations**

- The SAPPMR must introduce quality controls so that information, especially in tender notices, is accurate, correct, true, and consistent with the relevant provisions of the PPL.

**Summary of Findings for Indicator 12 (Ethics and anticorruption measures are in place)**

- The Kyrgyz Republic is a signatory of the UN Convention on Anti-Corruption as of August 2005. In October 2005, the National Anticorruption Council was established and an Anticorruption Agency was set up. The legal framework on anticorruption is adequate as discussed above, but implementation of the anticorruption legal framework is weak. The Anticorruption Agency is still in the preparation stage of its fight against malfeasance. Moreover, no nexus seems to
connect the PPL and the anticorruption legislation to identify the punitive consequences of corrupt behavior in procurement and the possibility of referral for criminal charges. The PPL would benefit from such a nexus since the procurement law only cites “bribery” and not other relevant prohibited acts such as collusion, coercion, fraud and, to some extent, obstructive practices.

Recommendations

- The GOK should align the PPL with the anticorruption legislation and strengthen its implementation.

Outstanding Weaknesses of the System: Risk and Mitigation Measures

6.21. Ineffective implementation of the May 2004 PPL is a major weakness of the Kyrgyz public procurement system. While a comprehensive legal framework is in place, the system suffers from deficiencies in actual practice as is well illustrated by the benchmarking described above. Deficiencies include absence of proper guidance to procuring entities; lack of procurement organization and capacity; undesirable procurement practices; poor budgetary allocation processes; inadequate external and internal controls; an unimplemented anticorruption agenda; and a weak supply side that mistrusts the procurement system.

6.22. The PPL clearly assigns procurement oversight and support roles to the SAPPMR. The SAPPMR is, however, unable to fulfill these roles efficiently and objectively. It lacks adequate capacity, and its involvement in actual procurement conduct, which is the responsibility of procuring entities, conflicts with its oversight role. The SAPPMR therefore provides little guidance to procuring entities to ensure effective implementation of the PPL. The agency has yet to prepare and disseminate a comprehensive implementation regulation and manual for use by procuring entities. Procuring entities at all levels of government are poorly organized. Some still conduct procurement through permanent tender commissions in disregard of the current PPL, which requires each entity to make one of its departments responsible for purchasing and give it the capacity necessary to do the job. Furthermore, qualified procurement professionals are generally in short supply. Consequently, procurement is being conducted by unqualified entity staff who receive rudimentary training from the National Procurement Training Center. The net result is weak implementation of the PPL and poor practices from procurement planning to contract management.

6.23. Procurement planning should begin with the budget formulation, but planning in fact is often simply a listing of items and their estimated costs for budgeting purposes. Multiyear procurement planning is not used. Even after the national budget is approved, adequate procurement plans are not prepared. Making existing plans public would help providers of goods, works, and services prepare better responses to tenders as they are launched, fostering optimal competition. Procuring entities receive funds late in the fiscal year, giving them insufficient time to conduct economical and efficient procurement. Information provided in tender notices is sometimes incorrect and
misleading; bidding documents sometimes are not easily available to interested bidders; allowable bid preparation time is too short; technical specifications are poor; contract award decisions frequently are made based on the lowest price instead of the lowest evaluated price; tenders are cancelled without notice or justification; contract management practices are slipshod; sometimes contracts are terminated without any justification; and so on. These poor practices, combined with a complaint resolution mechanism that appears to lack objectivity and transparency, has led the providers of goods, works, and services to lose trust in the system.

6.24. The supply side is improving but still weak. The construction industry has made good progress during the past decade, but is still unable to qualify for large contracts. Manufactured goods are mostly imported. The consulting industry is in its infancy.

6.25. The above mentioned recommendations have been included and prioritized for action in Annex 1 – Summary of Recommendations. The recommendations will be discussed with SAPPMR with a view to preparing a concrete action plan.
7. FIDUCIARY ISSUES IN BANK-FINANCED PROJECTS

7.1. Fiduciary risk refers to the possibility that funds provided by budgetary authorities or development partners will be misused or stolen. In the context of development aid, fiduciary risk also includes the possibility that actual expenditures will diverge from authorized expenditures reflected in the borrowing country’s budget, whether through misappropriation or misallocation. Traditionally, fiduciary risks in donor-financed projects were mitigated through ring-fenced arrangements for project implementation. Where country systems have been used, these have been accompanied by specific risk mitigation and capacity-building measures to reduce the risks to manageable levels.

Key Issues Identified in Previous Diagnostic Reports

7.2. The 2004 Country Financial Accountability Assessment reported that fiduciary risks in Bank-financed projects were managed by establishing ring-fenced Project Implementing Units (PIUs). These PIUs installed separate project financial management systems distinct from government accounting and reporting systems and maintained a separate audit trail for project transactions. Annual project financial statements were audited by private audit firms acceptable to the Bank.

7.3. The CFAA noted major internal control weaknesses, even within the ring-fenced agencies. These included weak organizational structure, which resulted in poor allocation of responsibilities for accounting and reporting on activities; noncompliance with Bank requirements, such as the injunction that Bank-provided funds not be commingled or used for activities other than those for which they were intended; and an inadequate accounting mechanism for counterpart resources.

7.4. Due to unavailability of adequate on-time counterpart funds, Bank funds were often used for pre-financing ineligible expenditures that should have been paid out of counterpart funds. Because of the small size of most Bank-financed projects in the country, no PIU had established an internal audit function. This would, however, be mitigated by having a full-time financial management specialist based in Bishkek to closely supervise and monitor the financial management of projects and provide quick guidance to the PIU staff.

7.5. The Bank did not place any reliance on audits conducted by the Chamber of Accounts. Instead, all Bank-financed projects were audited by private sector audit firms, mainly the Big Four audit firms with staff based in Almaty, Kazakhstan. In June 2001, the Bank carried out an on-site assessment of audit firms in the Kyrgyz Republic to

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26 Health and Social Protection (SWAp) Project
assess their eligibility to audit Bank-financed projects. The review revealed that most local firms lacked the technical capacity and requisite experience to carry out such audits. Other than the Big Four audit firms, only one local firm was considered eligible to carry out project audits. This firm appeared to monopolize auditing of Bank-financed projects, and concerns were raised about the technical quality of its audits. Because of the weaknesses in the country's PFM systems and in the financial accountability framework, the CFAA recommended that ring-fenced control be maintained for Bank-funded investment projects until the systemic weaknesses were adequately addressed.

7.6. Considering the failure of several banks in the Kyrgyz Republic, the CFAA also recommended a fiduciary assessment of commercial banks. This would pertain to commercial banks holding project special accounts. The assessment would evaluate the risk to the special account funds on deposit. This was crucial because all Bank-financed projects in the country had their special accounts in commercial banks.

Features of Current Arrangements for World Bank-financed Projects

7.7. Most Bank-financed projects are still implemented within ring-fenced arrangements because of continuing concerns about capacity and fiduciary risk. The country's PFM systems—especially accounting, reporting, and internal control—are still quite weak. The capacity of the Chamber of Accounts has not improved sufficiently to enable the Bank, or indeed other development partners, to rely on COA audits. Most PIUs have established satisfactory financial management and procurement arrangements. Most have experienced and skilled financial management and procurement staff who have benefited from regular training programs organized by the Bank within the country or regionally.

7.8. Bank-financed projects have installed automated accounting systems that generate required interim financial reports. These have been submitted on a regular and timely basis. Project audits continue to be performed by eligible private sector auditors. Audit reports for the past few years have been submitted on time, and most have not raised serious issues of accountability. Some weaknesses in accounting and internal control have been highlighted in audit reports and management letters, as well as in financial management supervision reports; but these have been satisfactorily resolved following intervention from the Bank.

7.9. Bank-financed projects are still not integrated in the annual budget. Generally, externally financed projects that are part of the Public Investment Program (PIP) have not been included in the annual budget on the revenue side with estimated loan receipts, and on the expenditure side with estimated project expenditures. The annual budget only reflects counterpart funds made available for project implementation. This practice distorts reporting on the amount of public investment in some sectors. The exception is the sectorwide Health and Social Protection Project, a SWAp. Although an investment project, it has some features of a budget support operation. The government is, however, moving toward integrating external donor funding into the national budget, and the 2007 budget included projects under the PIP for the first time.
7.10. **The overall fiduciary risks in Bank-financed projects have been moderate.** There are a few projects in sectors where the risks have been high, especially projects implemented by public utilities and those with community involvement and multiple cash transactions. In such cases, appropriate risk mitigation measures have been designed to bring the residual risks to acceptable levels. Such measures include extensive risk-based financial management supervision at regular intervals, and more in-depth scrutiny of accounting and internal control systems through operational reviews. All new projects are required to have satisfactory financial management arrangements before implementation.

**Health sector**

7.11. In 2005, the Bank and a number of development partners came together to support the country’s health reform program—Manas Taalimi—using a sector-wide approach. Under this program, the joint financiers agreed to pilot country systems for budgeting, accounting, reporting, and audit. However, prior to agreeing to the use of country systems, it was decided that a sector fiduciary assessment be carried out to determine the level of fiduciary risks and design appropriate risk mitigation and capacity development measures.

7.12. **The Health Sector Fiduciary Assessment (HSFA)** contained a fiduciary risk matrix table and a set of risk-mitigation and capacity-building measures. When fully implemented, these would give the joint financiers and the Government a level of assurance that funds under the program would be used as intended. The measures included development of a program operational manual (POM); establishment of an internal audit function in the health sector, initially within the Ministry of Health (MOH) and the Mandatory Health Insurance Fund (MHIF), and provision of consultancy support to the newly established internal audit units; automation of accounting systems in health care facilities; training of accounting and health personnel; a twinning arrangement for the Chamber of Accounts to help build its capacity and to conduct joint financial statement audits of the health care program; and a requirement for an in-depth internal control/operational review and regular financial reporting.

7.13. **Despite some delays, implementation of the risk-mitigation and capacity-building measures have progressed well.** Internal audit units have been established, a twinning contract has been signed with the UK National Audit Office, and a program operational manual has been adopted. It is expected that lessons learned in this pilot operation will inform considerations by the Bank and other development partners on greater reliance on country systems going forward. In particular, it is expected that the twinning arrangement for the Chamber of Accounts will help build necessary capacity to enable COA to conduct audits in accordance with the requirements of the law and international best practice.

**Education sector**

7.14. **The CFAU team also made a brief assessment of the procurement capacity of the Ministry of Education (MOE).** The MOE Rehabilitation, Monitoring, and State Procurement Unit, which reports directly to the minister, has two staff members assigned
to procurement with public funds. Both have received training and have practical experience. The leading specialist, who mainly deals with procurement, has also received training in conducting procurement according to the World Bank procurement and consultant guidelines. This unit handles procurement for MOE and its affiliated bodies, including several schools. It cooperates with the technical departments of MOE as needed.

7.15. **Procurement for educational institutions at the oblast and rayon levels is the responsibility of respective department of education (DOEs).** Each oblast and rayon has a DOE that conducts purchasing through its procurement unit. MOE is not involved in the procurement of learning materials, textbooks, or rehabilitation of schools. Nevertheless, the capacity of public officials at the oblast and rayon levels generally appears to be weak. They are not normally familiar with the requirements of the PPL; and in any case, they are not in a position to compel enforcement. The net result of this lack of procurement capacity and proper internal and external control is inefficiency that generates substantial economic losses of public expenditure through higher prices paid for goods, works, and services and from corruption. Schools report substandard repairs, educational equipment, and textbooks that were imposed because they had no say in the procurement process. Capacity building in procurement appears to be needed at all levels of the education sector—central, regional, and local.

**Movement toward Greater Reliance on Country Systems**

**Financial management**

7.16. **Standalone project implementation units have been a necessary short-term, risk-mitigating strategy.** Generally fiduciary arrangements for Bank projects function well in the Kyrgyz Republic. 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. The government has explored the possibility of integrating PIUs within line ministries and consolidating fiduciary functions as an alternative to multiple PIUs within ministries. The idea is a good one, although little progress has been made toward implementation more than a year after it was vetted. In parallel, the government’s current efforts in public finance reforms, if sustained, will strengthen public sector financial management arrangements and allow increasing reliance on country systems.

7.17. **Ongoing PFM reforms should strengthen accounting and reporting; increase transparency and accountability; and create a modern Treasury function and institutions of control, audit, and supervision.** As the government makes progress in implementing the PFM action plan, the Bank may progressively begin to rely on elements of the government’s financial management systems. However, decisions will be taken based on reviews conducted on a case-by-case basis. Elements of the country’s PFM architecture that are likely to benefit from the ongoing PFM reforms include Treasury operations, budget formulation and execution, accounting and reporting, internal control, internal audit, and external audit. These efforts will help reduce fiduciary risks associated with the use of country systems and enable greater use of these systems.
7.18. Any decisions for more widespread use of country systems will be based on considerations about progress by implementing agencies (line ministries) to establish sound financial management arrangements. These include: (a) reliable accounting and timely reporting systems; (b) robust internal control systems with clearly defined managerial accountabilities; (c) effective internal audit functions capable of detecting weaknesses in the system, and recommendations for remedial measures; (d) an independent and competent external auditing agency to conduct financial statement audits and; (e) transparent procurement systems. An efficient treasury system capable of managing funds, tracking collections, and making payments would also have to be in place as part of the overall PFM system.

**Procurement**

7.19. Based on the experience in the health sector and the brief assessment of the education sector, it appears that substantial procurement capacity-building efforts will be needed before donors can even partially rely on the country procurement system. While the MOH has taken the necessary steps under the Health SWAp—such as establishment of a procurement sector, appointment and training of two procurement staff, and preparation of a procurement capacity building plan for staff at regional and local health-related agencies—the MOE should consider instituting the same procurement capacity building measures.

**Government anticorruption measures**

7.20. In August 2005, the Kyrgyz Republic ratified the UN Convention against Corruption. In October 2005, the National Anticorruption Council was established by presidential decree. The council that oversees the agency includes 11 members representing Parliament, the Presidency, the civil service, the Supreme Court, civil society, and the head of the National Anticorruption Agency. The agency has 49 staff members. It is, however, new; and it has yet to implement any anticorruption programs.
ANNEX 1

SUMMARY OF RECOMMENDATIONS

In addition to implementation of the PFM Action Plan approved by Presidential Decree No. 337 of June 29, 2006, part 1 of the following table summarizes recommendations to accelerate reforms in the public finance management. These will need to be prioritized and incorporated as an annex to the PFM action Plan. Part 2 of the table summarizes recommendations to improve the public procurement system.

### Part 1 - Summary of Recommendations on Financial Management

<table>
<thead>
<tr>
<th>Measures</th>
<th>Objectives</th>
<th>Timeframe*</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Public Sector Accounting and Reporting</td>
<td></td>
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<tr>
<td>Finalize the Chart of Accounts and implement the cash-based IPSAS as presented and recommended under the USAID funded project (continued TA will be required to the newly created Division of Methodology for Financial Reporting and Internal Audit)</td>
<td>To provide a unified method of accounting by budget organizations, and to ensure reliability and comparability of financial reporting</td>
<td>Short term</td>
</tr>
<tr>
<td>Government should seek technical assistance to move toward preparation of consolidated financial statements for the government as a whole</td>
<td>To present financial statements for the government as whole and facilitate financial statements audit by the Chamber of Accounts</td>
<td>Medium term</td>
</tr>
<tr>
<td>Ministry of Finance should seek donor support to outsource public sector financial management and accounting training to established training organizations in the Kyrgyz Republic with the track record</td>
<td>To ensure continuity of training and consistent quality standards. Initial donor support may be needed to engage a training coordinator in the Ministry of Finance, to investigate training needs and develop coordinated training plans</td>
<td>Short term</td>
</tr>
<tr>
<td>Establish a Training Center for public sector officials including accounting, finance and procurement personnel</td>
<td>To create a critical mass of trained officials to sustain reforms in public sector, especially in PFM</td>
<td>Long term</td>
</tr>
<tr>
<td>Introduce a system of management accounting in the public sector</td>
<td>To provide useful information for performance measurement and managerial decision making</td>
<td>Long term</td>
</tr>
</tbody>
</table>
### b. Internal Control and Internal Audit

<table>
<thead>
<tr>
<th>Accelerate the computerization of Treasury operations, with major overhaul of Treasury Business processes</th>
<th>To improve efficiency and accuracy of data input and improve timeliness of Treasury reports</th>
<th>Medium term</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>b. Internal Control and Internal Audit</strong></td>
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</tr>
<tr>
<td>Accelerate process towards enactment of the law on internal audit and establish appropriate organizational framework for internal audit in the public sector (there is urgent need to reconcile the draft law with a parallel draft submitted by the COA)</td>
<td>To establish a legal and institutional framework for internal audit function for a sound internal audit system</td>
<td>Priority</td>
</tr>
<tr>
<td>Role of the Financial Control Division in the Ministry of Finance to be clarified</td>
<td>To remove doubts and ambiguity of the direction taken by the government to establish modern internal audit function and allays fears about revival of control and revision units</td>
<td>Priority</td>
</tr>
<tr>
<td>Create a centralized and secure database of employees in the public sector, and computerize payroll processing</td>
<td>To strengthen internal controls in payroll processing</td>
<td>Short term</td>
</tr>
<tr>
<td>Review the structure and distribution of bonuses and allowances paid to public officials</td>
<td>To rationalize the structure of allowances based on transparent criteria, such as performance appraisal</td>
<td>Short term</td>
</tr>
<tr>
<td>Seek technical assistance to develop a framework for a Public Internal Financial Control (PIFC) strategy.</td>
<td>To further strengthen internal controls and increase efficiency and effectiveness in the use of public resources, focusing on the two pillars of managerial accountability and functionally independent internal audit</td>
<td>Long term</td>
</tr>
<tr>
<td><strong>c. External Audit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Review the legal framework of the Chamber of Accounts to increase its independence</td>
<td>To enhance independence and effectiveness of the Chamber of Accounts as the Supreme Audit Institution</td>
<td>Medium term</td>
</tr>
<tr>
<td>Improve transparency in the appointment process of the COA chairman and members of the Council</td>
<td>To secure the integrity of the COA, and ensure security of tenure for the chairman and council members</td>
<td>Medium term</td>
</tr>
<tr>
<td>Strengthen capacity of the COA by a combination of twinning arrangements with well-established SAIs and sustained training, both in-country and overseas</td>
<td>To strengthen the capacity of the COA to perform financial statements and performance audit</td>
<td>Priority</td>
</tr>
<tr>
<td>Strengthen the capacity of the parliamentary committee by providing exposure to international best practices and building research and analytical capacity to follow up on audit findings and recommendations</td>
<td>To improve public financial accountability and transparency, and to strengthen the enforcement capacity to ensure compliance with audit recommendations</td>
<td>Medium term</td>
</tr>
<tr>
<td>Enact specific legislation to require follow up of matters arising from the Chamber of Accounts Audits</td>
<td>To make the COA more effective, and empower parliamentary committee to follow up issues raised in the audit reports</td>
<td>Medium term</td>
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</tbody>
</table>

**d. Use of Country Systems**

| Accelerate implementation of the PFM action plan, and other recommendations contained in this report to strengthen the country’s PFM systems (Development partner should support the government to develop prioritized PFM capacity development plan) | To reduce fiduciary risks in the use of Country systems and promote greater reliance on national systems for implementing donor-funded projects (Development partners should progressively begin to place greater reliance on country systems) | Medium term |
| The government should move toward integrating external donor funding in the national budget | To ensure completeness of presentation of public sector resources and spending in the National Budget | Ongoing |

* Note: *Short term* measures generally refer to the timeframe of 1 to 2 years. *Medium term* refers 2 to 5 years. *Long term* refers to more than 5 years. *Ongoing* indicates implementation has commenced.
# Part 2: Summary of Recommendations on Procurement

<table>
<thead>
<tr>
<th>Measures</th>
<th>Objectives</th>
<th>Time frame*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar I. Legislative and Regulatory Framework</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discontinue licensing activity of the SAPPMR by implementing the MOF order of March 29, 2007, amending the MOF Order of October 18, 2001 “On opening and maintaining of Treasury accounts for registration of operations on execution of expenditures of the state budget of the Kyrgyz Republic by regional divisions of the Central Treasury of the Ministry of Finance.”</td>
<td>To ensure that the SAPPMR focuses on its main role of providing support to procuring entities and to oversee the procurement function to ensure compliance with the PPL.</td>
<td>Short Term</td>
</tr>
<tr>
<td>Prepare and disseminate an implementing regulation and a manual for providing detailed guidance to procuring entities. (This recommendation was also included in the 2002 CPAR Action Plan).</td>
<td>To explain with a view to improving the understanding among the procuring entities’ staff involved in conducting procurement of different provisions of the PPL, including, among others, preparation of procurement plans, bidding documents, use of pre- and postqualification, bid submission/opening procedures, evaluation methodologies, preparation of minutes, etc.</td>
<td>Short Term</td>
</tr>
<tr>
<td>Prepare model technical specifications for the frequently procured goods and works, and train staff of procuring entities in preparing clear technical specifications (Also included in the 2002 CPAR Action Plan), and introduce the concept of “substantial equivalence and responsiveness.”</td>
<td>To facilitate the task of procuring entities of preparing broad, clear and concise technical specifications for efficient and economic procurement.</td>
<td>Medium Term</td>
</tr>
<tr>
<td><strong>Pillar II. Institutional Framework and Management Capacity</strong></td>
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</tr>
<tr>
<td>Implement Prime Minister’s Resolution No. 2 of January 9, 2007, on organization of procuring entities.</td>
<td>To organize and strengthen procuring entities for an effective implementation of the PPL.</td>
<td>Ongoing but needs to be expedited.</td>
</tr>
<tr>
<td>Strengthen SAPPMR’s structure and staffing.</td>
<td>To increase SPPMR’s efficiency and focus on its</td>
<td>Short Term</td>
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</tbody>
</table>
## Pillar III. Procurement Operations and Market Practices

<table>
<thead>
<tr>
<th>Measures</th>
<th>Objectives</th>
<th>Time frame*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve procurement planning from the beginning of the budget cycle, and streamline budgetary processes to make funds available to procuring entities in a timely manner for economic and efficient procurement.</td>
<td>To plan procurement adequately before budgetary funds become available; and once funds are available, to conduct procurement efficiently and economically in a timely manner within a given fiscal year</td>
<td>Medium Term</td>
</tr>
<tr>
<td>Require procuring entities to obtain written assurances from the Treasury of funding availability before a tender for goods, works, or services is launched. (The Action Plan of the 2002 CPAR included the following: “Procuring entities to launch tenders only upon MOF confirmation of availability of funds for timely contractual payments.”)</td>
<td>To make payments to providers of goods, works, and services in a timely manner, improving competition for future contracts to create economy</td>
<td>Short Term</td>
</tr>
<tr>
<td>Make procurement data collection more effective (i.e., systematically require procuring entities to submit data to the SAPPMR) and establish and maintain a computerized database for procurement data. (This is also included in the 2002 CPAR Action Plan.)</td>
<td>To ensure that good quality data is available for analysis of procurement processes (e.g., use of competitive vs. noncompetitive procurement methods), facilitating corrective measures.</td>
<td>Short Term</td>
</tr>
<tr>
<td>Improve quality of information contained in tender notices, contract award notices, and other items published in the Public Procurement Bulletin (PPB), and enhance use of the PPB to disseminate information about good procurement practices.</td>
<td>To improve system transparency and enhance private sector trust in its reliability</td>
<td>Short Term</td>
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### Pillar III. Procurement Operations and Market Practices

<table>
<thead>
<tr>
<th>Measures</th>
<th>Objectives</th>
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<tbody>
<tr>
<td>Develop mechanisms to improve partnership between the public and private sectors, including providers of goods, works, and services, and civil society.</td>
<td>To interact frequently with civil society to introduce social auditing, and with consultants, contractors, and suppliers to ensure their continued interest in government tenders and to improve their understanding of procurement legislation requirements</td>
<td>Long Term</td>
</tr>
<tr>
<td>Prepare a simple manual on contract administration, and design training for contract</td>
<td>To ensure efficient, timely, and cost-effective contract</td>
<td>Medium Term</td>
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<tr>
<td>Measures</td>
<td>Objectives</td>
<td>Time frame*</td>
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<td>administration.</td>
<td>performance</td>
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<tr>
<td>Make the National Procurement Training Center self-sustainable by providing budgetary resources to procuring entities so that they can pay for its services. Introduce a testing and certification system for procurement officials to become procurement professionals.</td>
<td>To ensure that the NPTC continues to function effectively with a view to creating a cadre of procurement professionals by testing their skills and certifying their professionalism</td>
<td>Medium Term</td>
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</table>

**Pillar IV. Integrity and Transparency of the Public Procurement System**

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Streamline the appeals mechanism by expanding the parties that can file complaints and expanding the grounds for complaints.</td>
<td>To enhance bidder trust</td>
<td>Medium Term</td>
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<tr>
<td>Align the PPL with the anticorruption legislation and strengthen its implementation.</td>
<td>To strengthen the PPL from such linkage since current procurement law does not include all prohibited acts, such as collusion, coercion, fraud, and obstructive practice</td>
<td>Long Term</td>
</tr>
<tr>
<td>Strengthen the capacity of Chamber of Accounts staff through training in procurement.</td>
<td>To ensure that the CA staff properly understand the procurement legislation to conduct meaningful procurement audits</td>
<td>Short Term</td>
</tr>
<tr>
<td>Prepare a code of ethics for procuring entity staff involved in carrying out public procurement.</td>
<td>To avoid conflict of interest</td>
<td>Short Term</td>
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* Note: *Short term* measures generally refer to the timeframe of 1 to 2 years. *Medium term* refers 2 to 5 years. *Long term* refers to more than 5 years. *Ongoing* indicates implementation has commenced.
## ANNEX 2

### UNIMPLEMENTED MAJOR RECOMMENDATIONS OF THE 2002 CPAR

<table>
<thead>
<tr>
<th>Recommendation in the CPAR</th>
<th>Status of Implementation</th>
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<tbody>
<tr>
<td>1. Abolish Article 30, “Cancellation of Tenders.”</td>
<td>The GOK partially amended Art. 29 (Art. 30 in the old PPL) according to the Bank’s recommendations, but Art. 29 is still worded unclearly and allows procuring entities to cancel tenders without valid reasons. This has become a common practice, leading to inefficient and uneconomical procurement that also lacks transparency and fairness.</td>
</tr>
<tr>
<td>2. Establish a Procurement Advisory Committee (PAC) to issue opinions on SAPPMPR draft annual reports about public procurement performance and on draft public procurement legislation and regulations.</td>
<td>According to the SAPPMPR, the PAC was established in pursuance of Regulation No. 583 of September 29, 2003. However, no activities by this committee have surfaced.</td>
</tr>
<tr>
<td>3. SAPPMPR should conduct essential rather than regular review of procurement documents (including bidding documents, evaluation reports, draft contracts, etc.) as needed to fulfill its oversight and monitoring function.</td>
<td>The MOF requirement of mandatory coordination by procuring entities with the SAPPMPR has been cancelled. The SAPPMPR is now expected to conduct only essential procurement review as required by the PPL.</td>
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<tr>
<td>4. Reorganize procuring entities to provide for an effective procurement framework in which each sizeable purchaser (such as ministries, municipalities, oblast administrations, etc.) should make its administrative or financial department responsible for procurement.</td>
<td>Only a few procuring entities have implemented this recommendation due to lack of resources. The SAPPMPR states that recent inspection findings show that separate procurement units have been established in the following government entities: the Ministry of Interior, the Ministry of Education; the Correctional Facilities Department; the Ministry of Health; the Ministry of Emergency; the State Committee for Migration; the Ministry of Labor and Social Protection; the Department of Water Resources; the Department of Plant Protection; the Veterinary Department; and in several joint-stock companies.</td>
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<tr>
<td>5. Dialogue within GOK to establish procurement as a separate career stream in the Kyrgyz civil service.</td>
<td>Delays have occurred in civil service reform. Implementation of this recommendation would ensure that public procurement is conducted only by qualified professionals at all levels of</td>
</tr>
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<td>6. Any findings on corruption in public procurement should be made public through publication in PPB and through the Web site.</td>
<td>Not implemented. It appears that current regulations do not permit publication of such findings.</td>
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<tr>
<td>7. Design a comprehensive sample-format procurement plan and disseminate it to procuring entities.</td>
<td>A format is in use but it is not comprehensive.</td>
</tr>
<tr>
<td>8. Prepare model technical specifications.</td>
<td>Model technical specifications have not been prepared because of insufficient resources. Absence of such models in areas where standardization is possible leads to poor-quality technical specifications. Use of poor technical specifications allows selection of the lowest-“priced” bidder instead of the lowest-“evaluated” bidder, without determining bid responsiveness to technical specifications and the requirements for qualifications, delivery/completion time, etc.</td>
</tr>
<tr>
<td>9. Before comparing bid prices, procuring entities should examine bids in detail to determine their substantial responsiveness to the requirements specified in bidding documents.</td>
<td>The common practice is to decide contract awards on the basis of the lowest price, even when it results in delivery of substandard goods and poor-quality construction of civil works.</td>
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<tr>
<td>10. SAPPMR should review contract performance on a sample basis to ensure compliance with the PPL provision that prohibits changes in contract terms and conditions if such changes affect the bidding conditions.</td>
<td>Procuring entities frequently make changes and adjustments in contracts that are concluded on the basis of poor quality technical specifications and the lowest bid price. This facilitates corruption. According to the SAPPMR, its inspection unit verifies the terms and conditions in contracts against the bids. Fines are imposed for unreasonable changes in the contract, and relevant materials are submitted to law enforcement agencies if necessary.</td>
</tr>
<tr>
<td>11. Procuring entities should launch tenders only upon confirmation from MOF of fund availability to pay contractors in a timely manner.</td>
<td>The practice of launching tenders without ensuring the availability of funds continues has not been discontinued. This leads to payment delays or non payments to suppliers of goods, works, and services.</td>
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<tr>
<td>12. SAPPMR should coordinate with the president’s administration in the design and introduction of e-procurement.</td>
<td>No progress has been made to date. To move reforms along in the introduction of e-procurement as recommended in the 2002 CPAR, regulations may need to be issued to</td>
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<tr>
<td>13. Improve procurement data collection from procuring entities for use in SAPPMR annual procurement reports. Improve the format of annual procurement reports and make them public. Establish computerized data collection and maintenance.</td>
<td>Because of inaccurate or absent data, SAPPMR is unable to fulfill its function of monitoring and evaluation to ensure compliance with procurement legislation and rules.</td>
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<tr>
<td>14. Include provisions authorizing the use of arbitration in contract disputes.</td>
<td>STDs mention application of reference tribunal (arbitration). There is no arbitration tribunal in the Kyrgyz Republic yet. Bidders often consider settlement of contractual disputes by commercial arbitration to be a more efficient and independent mechanism than submission of such disputes to local courts (and may therefore produce better prices). Although arbitration provisions can be achieved in the Conditions of Contract, it is also useful to explicitly mention in any future revisiting or amendment of the PPL that one fair contract condition would be a provision for settlement of disputes under the last paragraph of Article 21(1). The parties should be afforded an opportunity to opt for the more efficient mechanism of arbitration compared to the more drawn-out court resolution under the civil code. Similarly, it is also worth noting that Article 62 on “Claims under Contracts” can also benefit from future amendment since the statute appears one-sided,</td>
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<td>covering only alleged nonperformance by the procuring entity. The mechanism should also cover claims of nonperformance by the supplier/contractor and outline the process for the offended procuring entity to pursue remedy.</td>
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