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ABBREVIATIONS AND ACRONYMS

ACU	Aid Coordination Unit
AsDB	Asian Development Bank
ASOSAI	Asian Organization of Supreme Audit Institutions
CAS	Country Assistance Strategy
COA	Chart of Accounts
CPAR	Country Procurement Assessment Report
ESW	Economic and Sector Work
FCR	Financial Control and Revision Department
FSU	Former Soviet Union
IAD	Internal Audit Department
IAS	International Accounting Standards
IASC	International Accounting Standards Council
IDA	International Development Association
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
JSC	Joint Stock Company
LICUS	Low Income Country Under Stress
MN	Majlisi Namoyanagon
MoE	Ministry of Economy
MoF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
NBT	National Bank of Tajikistan
OECD-DAC	Organization for Economic Cooperation and Development – Development Assistance Committee
PEIR	Public Expenditure and Institutional Review
PIP	Public Investment Program
PIU	Project Implementation Unit
PRFG	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
SAI	Supreme Audit Institution
SAC	Structural Adjustment Credit
SFCC	State Financial Control Committee
SME	Small and Medium Sized Enterprise
SOE	State Owned Enterprise
SPC	State Property Committee
SPF	Social Protection Fund
UNDP	United Nations Development Program

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PREFACE

This report was prepared after missions to Tajikistan in 2002 and 2003 by a Task Team comprising Andrew Mackie, Task Team Leader, (ECSPS), Sandro Zanus Michiei, Lead Financial Management Specialist (ECSPS), Allen Wazny, Senior Financial Management Specialist (ECSPS) and Aziz Khaidarov, Local Research Consultant. The team cooperated closely with Bank staff who were engaged in a Public Expenditure Institutional Review (PEIR) conducted during the mission, which included Roland Clarke and Tony Verheijen, Senior Public Sector Management Specialists.

The report is based on interviews with officials and staff at public institutions, as well as on detailed analyses of laws, documents and other information. Government counterparts lent their full and proactive support and engaged with the Bank team in a comprehensive dialogue about the issues identified by the assessment. A draft CFAA was submitted to the Government in June 2003 and the Team conducted a workshop in Dushanbe in October, 2003, when it discussed the findings of the Report with participants and senior government officials. The Bank is grateful to the Government of Tajikistan for this cooperation.

Scope of the Report

This CFAA concentrates principally on public sector financial management. Its results will serve as a fiduciary tool in developing future lending strategies for Tajikistan and highlight areas where the donor community can support the Government's public sector reform program. The CFAA also clarifies the Bank position regarding the financial management of on-going projects, particularly on the capability of Tajikistan's institutions in the area of public financial accountability. The CFAA complements the PEIR and CPAR, both of which will be completed in the next twelve months.

Purpose of the Report

A CFAA considers the strength of the financial accountability framework in both the public and private sectors. The aim is to assess whether existing practices can ensure proper use of funds- both the country's own resources as well as those provided by the Bank and other institutions.

A key aim is to assess the risks that the financial accountability framework poses for implementing Bank programs and using Bank funds, and to propose suitable measures to manage them. It also supports dialogue with the borrower country and development partners on financial accountability matters, and helps design programs to build financial management capacity.

While a CFAA diagnoses a country's financial management systems, it is not an audit and does not assure that all funds are being used for their intended purposes. Rather, it provides a well-informed and objective assessment of the strengths and weaknesses of financial management systems, a diagnosis of problems and advice on their resolution, and an indication of the level of financial risk.

Each CFAA is expected to evaluate the following aspects of a country's public and private sector financial management:

- Budget development – comprehensiveness, realism, classifications and processes
- Budget execution and monitoring – internal controls, information systems, cash flow and debt management
- External fiscal reporting and transparency
- Internal and external audits
- Legislative scrutiny of budget execution
- State-owned enterprises – transparency, governance, monitoring and supervision
- Accounting profession capability and education
- Fiduciary risks in Bank- assisted projects.

In the context of a country's governance environment, the executive arm of the Government is obliged to safeguard public resources and use them properly; also, it must provide a credible legal/regulatory framework to promote good financial governance in both private and public sectors. The institutional and legal/regulatory regime created to provide this assurance constitutes a country's public financial accountability framework. In the private sector, the framework should provide reasonable assurance that financial operations are conducted properly and that investments are managed with due care and protected from fraud and misuse.

Scope and terms of reference of CFAA

The scope and terms of reference of the CFAA were articulated and agreed both internally within the Bank and externally with the Government of Tajikistan in the CFAA Initiating Concept Memorandum of February 3, 2003.

Acknowledgements

The Mission wishes to acknowledge the extensive cooperation and assistance received from officials and staff of the public organizations, state agencies and other institutions interviewed. Grateful thanks go also to the Bank's Public Expenditure Institutional Review task team as well as the staff of the World Bank funded Institutional Building and Technical Assistance II Project for their considerable research on which a significant proportion of this CFAA is based. Cevdet Denizer, Country Manager, ECCTJ provided extensive in-country assistance and invaluable advice. John Hegarty, Financial Management Manager, ECSPS and peer reviewers David Shand, Financial Management Adviser, OPCFM; Alma Kanani, Senior Public Sector Specialist, SASPR; and Peter Dean, Consultant, offered much appreciated comments and inputs; and Ana Cristina Hirata and Roula Balkash, ECSPS assisted with the editing and formatting of the report.

EXECUTIVE SUMMARY

Tajikistan's economic and political transition until 1997 was largely influenced by two factors: The loss of transfers from the former Soviet Union and the civil war that erupted in 1992. The signing of a peace accord in 1997 brought a more stable political environment but the country faces several issues which make future development extremely challenging: For example, it is geographically isolated, has under-developed natural resources and shares 1,200 kilometers of border with Afghanistan. Further, over 80 percent of the population is below the poverty line and about 30 percent live in absolute poverty. Nevertheless, in recent years Tajikistan has managed strong economic growth, albeit from a low base.

The Government's Poverty Reduction Strategy Paper (PRSP) identified effective governance as one of the four elements needed to tackle poverty. The PRSP found that current systems of public administration have obsolete structures, inadequate personnel and duplicated functions, and lack cohesion. Indeed, the weak institutions and governance problems undermine the efforts to implement structural reform and threaten the sustainability of the country's recent economic growth. The Government has taken measures to tackle these problems—such as creating a treasury system in 1999 and approving laws on the budget system and State financial controls in 2001. While the legislative reforms were welcome, additional actions are needed to develop the capacity of the executive, legislative and judicial branches of government.

This CFAA, the first for Tajikistan, is a key diagnostic study aimed at identifying the overall financial management risks. Its timing coincides with a meeting of the Tajik Consultative Group in April 2003, which pledged US\$900 million of support over the next three years. Addressing the numerous, systemic financial management weaknesses in Tajikistan will have an important impact on the governance arrangements which, in turn, will affect donor disbursements against these commitments. In this respect, the CFAA also aims to provide a roadmap for future advice and technical assistance in public sector accountability. It assesses structural reforms in public sector budget management, accounting and financial reporting, the treasury system, internal controls and internal and external audits. It also examines the mechanisms of public accountability at the sub-national and community levels.

OVERALL FIDUCIARY ASSESSMENT

Because the country's fiduciary environment is extremely weak, the CFAA assessed the risk to public funds as high. It noted that systems of public accountability function poorly and public sector transparency is still a problem at all levels of government. Control and supervisory checks and balances are weak. While legislative reforms were introduced to the Treasury, budget processes and control agencies, they could be undermined through capacity constraints (both human and technological). Some of the main risks involve fragmented budgets, poor cash management and execution controls, lack of transparency in state-owned enterprises' (SOEs) and inadequate checks and balances in the Government and Legislature. In turn, the risks affect the quality and credibility of governance.

The risks posed by the weaknesses in financial accountability, in both the private and public sector, concern the World Bank from a fiduciary perspective. To reduce these risks, Tajikistan

must fundamentally change the objectives and institutional arrangements governing financial management. And, since the financial accountability framework is weak, tight control must be maintained over Bank-funded investment projects--until the systemic weaknesses are adequately addressed. For adjustment lending, it is recommended that loan proceeds be disbursed into a ring-fenced deposit account in the name of the National Bank of Tajikistan at a correspondent bank acceptable to the World Bank and that this account be independently audited.

To enable the Bank to place greater reliance on systems of public accountability, the Government and donor community are working to improve overall financial management. To date, the Bank has been focusing on budgetary and public administration reform, the IMF has been providing support to improve treasury systems, external debt management and controls, the AsDB is providing technical assistance to the external Aid Coordination Unit, and USAID has recently begun providing assistance to improve accounting standards. Although all these activities will affect the quality of financial accountability, the Development Action Plan (see Annex 1) notes that the challenge is significant and will require sequenced technical assistance over the short, medium and long term.

The World Bank, other MDBs and bilateral donors recently committed to working more closely together in order to coordinate their financial management requirements across their client countries. Given the desperately low financial management capabilities in Tajikistan, it is important to identify opportunities to reduce the transaction costs of doing business with the donor community. The CFAA recommends that, in line with the OECD-DAC guidelines, the donor community should develop a joint strategy to reduce such costs and better coordinate financial management requirements.

The main sources of risk and the key recommendations for establishing a sound financial accountability framework are described below.

Budget fragmentation. The Law of State Finances (2002) is a modern, well-constructed law on budget processes. However, it will be difficult to apply due to the limited capacity of the Ministry of Finance (MoF) and line ministries, and the fragmented nature of the budget preparation process. In addition, quasi-fiscal activities, particularly in the energy sector, are extensive and not fully reported in budget documents. These issues translate into a level of risk that is unknown and make it impossible to ensure that funds are used transparently and for the purposes intended.

Failure to link budget processes to strategic priorities. The PRSP and Medium-Term Expenditure Framework (MTEF) are not effectively linked into the budgetary process. Institutionally, the budget processes are centralized within the MoF; and, it is difficult to determine whether public expenditures reflect strategic priorities or respond to the various stakeholders in the budget debate.

Inadequate cash and debt-management arrangements. Such arrangements are hampered by serious problems: (1) weak systems of cash management or forecasting exists, which creates arbitrary variations in payment dates and inefficient use of resources; (2) the system of prioritizing payments is excessively centralized and requires daily decisions on the part of

senior MoF officials; (3) cash controls are particularly weak in local treasury branches which still largely use manual systems; (4) systems developed to record and control commitments are incomplete and there is no system to record arrears within the Treasury; and (5) several instances of misreporting of state debt have occurred in recent years. The Government has taken several recent actions to address the issues listed above, notably the recent creation of the External Debt Management Unit within the Ministry of Finance; supported by technical assistance from the IMF. The present environment has still got significant weaknesses through a highly inefficient and ineffective use of cash and the a risk of misappropriation of funds through weak controls, particularly in the local treasury branches.

Weaknesses in public sector accounting and financial reporting. The treasury accounting process is hampered by a lack of computerization in local treasury offices; this slows the consolidation process and leaves little time for critical analysis, monitoring and supervision. Line ministries adopt an accrual-based accounting system, while the Treasury uses a cash-based approach. Further, there are deficiencies in the accounting regulations and the information provided is not being used to manage budgetary institutions. Moreover, while the Law on State Finances (2002) provides for a comprehensive annual budget execution report, compliance is undermined by weaknesses in the technical capacity of financial managers and lack of systems to fully capture accounting data across Government.

Ineffective internal audits within Government. The Financial Control and Revision Unit in the MoF was disbanded in 2001 when the State Financial Control Committee was created. The existing control framework fails to address the role, functions and accountabilities of internal audit within Government. A clear differentiation of the role of internal and external audits has yet to evolve.

Weak institutions of public accountability. While the creation of the SFCC is a positive development, the Committee needs to conduct its activities in a more transparent and open manner. Further, although it has extensive legal powers and responsibilities, capacity is seriously constrained, which means it has difficulty carrying out its mandate. Similarly, the Parliamentary Budget Committee does not have the capacity to carefully scrutinize budget submissions or enough technical staff with which to analyze budget proposals and execution reports.

Weak governance and monitoring of state-owned-enterprises (SOEs). The State-owned sector is substantial, despite the ongoing process of privatization. In the energy sector, quasi-fiscal expenditures are estimated to be around 6-10 percent of GDP and a large stock of arrears exist, but are inadequately controlled or reported by Government. Also, SOE governance arrangements are fragmented and lack transparency.

Recommendations

The most important recommendations to address the weak public sector accountability system are as follows:

- Improve the timeliness and accuracy of accounting and financial reporting. To achieve this, the Government must build on the first phase of treasury reforms by (1) improving

the links between local and central treasury networks and (2) integrating accounting between treasury and budgetary institutions.

- Develop the newly created inter-ministerial Budget Commission¹ to (1) oversee the development of medium-term revenue and expenditure forecasts, (2) approve budget instructions, (3) approve aggregate resources the Government expects to mobilize during the next fiscal year and (4) set expenditure ceilings for line ministries.
- Create a Cash Management Unit within the MoF with appropriate staff training and capacity building to improve their methodological skills.
- Constitute all SOEs as joint stock companies with Boards that have clearly defined roles and responsibilities. Prepare and audit financial reports of key SOEs according to international standards that are transparent and available to the public.
- Prepare a strategy for developing public sector internal audits that covers (1) staffing and skill requirements, (2) approaches and methodology and (3) structural/institutional arrangements.
- Strengthen institutions of public accountability by (1) improving SFCC's capacity to conduct financial attestation audits and (2) revising the audit methodology according to international norms. Parliamentary scrutiny should be strengthened by improving the reporting lines between itself and the SFCC. In the long term, CFAA recommends to subordinate the SFCC to the Parliament.

See Annex 1 for a matrix of the proposed action plan.

PRIVATE SECTOR FINANCIAL ACCOUNTABILITY

Even by the standards of its neighbors, overall governance, financial reporting and auditing in Tajikistan are extremely poor, due in large part to the country's isolation and lack of foreign investment. As a result, the business community, accountants and civil servants are not familiar with concepts of financial accountability. For this reason, all aspects of basic financial management training are needed. The Government, with the support of donors, has started addressing accounting and audit reforms, but development will be hampered by a lack of financial expertise. Also, the foundations for a modern auditing profession are extremely weak; none of the international audit firms have representative offices in Tajikistan, and the demand for audits is largely driven by the requirements of aid and development organizations. In addition, audits are often seen as an extension of control activities, which has created resistance to introducing audit legislation. Finally, while commercial banks are required to apply International Financial Reporting Standards, due to financial and capacity constraints, they have not been adopted in day-to-day operations.

Recommendations

¹ This Commission would be separate from the Budget Committee in Parliament.

The main recommendations to address the weak private sector accountability arrangements are as follows:

Financial reporting

- Adopt a fully translated set of International Accounting Standards (IAS) as the National Accounting Standards. Compliance should focus on public interest companies that would include (but not be limited to) banks, insurance companies, other financial institutions/ intermediaries and significant publicly and privately owned enterprises.
- Relax the requirements for International Accounting Standards (IAS) reporting for small and medium-sized entities according to guidance from the IASC, when it becomes available.
- Include representatives of enterprises, key SOEs and audit firms in the Government's working party on financial reporting.

Auditing

- Apply the statutory audit requirement to financial institutions, listed companies (if any) and entities of significant public interest, including SOEs. Also, mechanisms to monitor and license auditors need to be revised in line with international norms.

DEVELOPMENT ACTION PLAN

It would be unrealistic and impractical for the authorities to try to simultaneously address the many recommendations in this report. The CFAA team discussed the draft assessment with the Government during the dissemination mission in October 2003 to clarify and prioritize the recommendations. Responsibility for implementing the Development Action Plan (DAP) rests with the President's Office, although the MoF, Majlisi Namoyanagon (Assembly of Representatives) and State Financial Control Committee will also play significant roles.

See the final Development Action Plan in Annex 1 of the CFAA.

I. COUNTRY CONTEXT

Governing Structures

1. The country consists of four tiers of government: (1) the central, Republican level, (2) the City of Dushanbe, two oblasts (Sugd and Khatlon) and one autonomous oblast (Gorno Badakhstan) which mainly have a unified budget relationship with the central Government; (3) the district level, where cities and *raions* are subordinate to oblasts--four districts are under Dushanbe city and 13 raions are under the republican budget; and (4) the community level, which includes villages and towns in rural areas (*jamoats*). Each oblast, raion and city has its own executive authority (*khukumat*).

2. The Constitution provides the President with strong powers, including the right to appoint and dismiss senior officials of the judicial and executive branches both in central and local government. The President is the main initiator of policies and does so with a team of advisors on the economy, legal issues, international affairs, social issues and human resources. In addition, several sector units in the Presidential Administration shadow the policy development work of the State institutions and exercise quality control over policy proposals prepared by line ministries and other institutions.

Economic Prospects and Public Sector Reform

3. Tajikistan's economic performance until 1997 was largely influenced by the loss of transfers from the former Soviet Union (which accounted for half of State revenues in 1990), and the eruption of civil conflict in 1992. The signing of the peace accord in 1997 brought a more stable political environment. However, several factors still make the road to development extremely challenging. For example, the civil war took 50,000 lives and destroyed much of the country's infrastructure. Also, Tajikistan is endowed with few natural and under-developed resources, is geographically isolated and shares 1,200 kilometers of border with Afghanistan. Further, almost the entire Government investment budget comes from official development assistance and the country has accumulated very high debt, with debt service absorbing 47 percent of fiscal revenues in 2001. Over 80 percent of the population are below the poverty line and about 30 percent are in absolute poverty.

4. Despite these enormous obstacles, Tajikistan achieved strong growth, averaging over 7 percent from 1999-2002, driven by the industrial and agricultural sectors. The country depends heavily on cotton and aluminum prices, which make up 70 percent of its exports. However, sluggish land reform and a weak banking sector profoundly impede sustained economic growth. Further, weak institutions and governance problems undermine efforts to introduce structural reforms and threaten the sustainability of the improved macroeconomic performance. Moreover, many groups accommodated in the peace accord are part of the Tajikistan power base and exploit rent-seeking opportunities. While the Government is aware of the weakness in public administration, financial management and the legal/judicial system, the low salaries make it difficult to attract new talent. Thus, progress in reforming key institutions is likely to remain slow.

Box 1 - Selected Macroeconomic Indicators, 1998 – 2002

	1998	1999	2000	2001	2002 ^a
Nominal GDP (US\$ mil)	1320	1087	991	1056	1135
Real GDP (% change)	5.3	3.7	8.3	10.2	8-10
GDP per capita (in US\$)	215	177	161	170	180
Consumer prices (12-month change, e.o.p.)	2.7	30.1	60.6	12.5	13.0
Consumer prices (year-on-year)	43.2	27.5	32.9	38.6	12.2
Budget deficit (% of GDP)	3.8	3.1	0.6	0.1	0.2
Merchandise exports (US\$ mil)	586	666	788	652	723
Merchandise imports (US\$ mil)	725	693	834	773	819
Current account balance (% GDP)	-9.1	-3.3	-6.3	-7.0	-4.1
Gross international reserves (months of imports)	1.5	1.7	2.1	1.9	2.3
External debt outstanding/GDP (%)	95	118	105	100	95-98
NPV-of-external debt/exports (%)	176	140	126
NPV-of-external debt/fiscal revenues (%)	579	514	408
Debt service ratio (% exports)	...	11.9	17.5	25.6	21.0
Official exchange rate (average, in Somoni/US\$)	0.8	1.2	1.8	2.4	2.76

Source: World Bank/IMF Staff Estimates

5. Governance and institutions are being further tested by a fallout from events in Afghanistan. The increase in drug use and trafficking since 1995 has accelerated substantially since the war; and growth in the latter is a major risk factor in the country's effort to improve governance.

6. Such are the enormous tasks that the Government and donor community face in shaping the new Tajikistan. Indeed, all aspects of the country need rebuilding--public institutions, local communities, physical infrastructure and human resources.

Strategic Directions and Policy Dialogue

7. The Government's Poverty Reduction Strategy Paper (PRSP) identified effective governance as one of the four elements needed to tackle poverty. The PRSP noted that the systems of public administration had obsolete structures, inadequate personnel, duplicated

functions and lack of cohesion, thus hindering economic reform. The Government has taken some measures to tackle these problems, creating a Treasury system in 1999, the Agency on the Procurement of Goods and Works in 2001, State Financial Control Committee in 2001 and the Ministry of Revenues in 2002. While these institutional reforms are welcome, additional actions are needed to develop the capacity of the executive, legislative and judicial branches.

8. The 2003 Country Assistance Strategy (CAS) emphasizes the importance of issues of governance, public sector management and accountability; recognizing that institutional barriers and capacity limitations in key public institutions are factors that inhibit growth and economic transformation. As Tajikistan works to build a better foundation for its core institutions in the medium to long term, the CAS also supports the immediate needs of the population, especially the poor, through a strong commitment to community-driven development.

9. This CFAA, the first for Tajikistan, aims to create the basis for future advisory and technical assistance in public sector accountability. It considers the work in progress in public sector budget management, accounting and financial reporting, the treasury system, internal controls and internal and external audit. Moreover, it examines the mechanisms of public accountability at the central, sub-national and community levels.

10. The Bank's interest in the CFAA lies in providing inputs for managing fiduciary risks and supporting its development objectives. The Bank's fiduciary responsibility to its shareholders and the borrowing government's fiduciary responsibility to its citizens are closely related: If the Government meets its responsibilities, the Bank's are also realized. The CFAA needs not only to focus on existing systemic weaknesses giving rise to fiduciary risks, but also to advise on development needs. Thus, the CFAA aims to identify and prioritize a long-term program of institutional building scaled to Tajikistan's modest implementation capacity.

11. Reforms to produce greater fiscal transparency and accountability require a comprehensive budget, accompanied by strong accounting, reporting and auditing systems. To this end, the Government has established a Treasury system, enacted a Law on State Finance, created the State Financial Control Committee and reorganized the tax administration authorities. However, further investment is needed to achieve consistent accounting and fiscal reporting in the public sector as a whole. In addition, while some progress has been made on budget execution, this effort needs to be complemented by improved policy and budget formulation, monitoring and evaluation of SOEs, greater effectiveness and transparency of external audits and legislative oversight, and a comprehensive strategy to tackle corruption.

12. At the same time, broad civil service reform is needed to overcome problems of duplicated functions, in order to standardize the chaotic and over-regulated policies faced by the private sector and investors. Through the Bank-financed IBTA2 project, the functions of key ministries have been reviewed, but the Government has been slow to act on the findings. Low public sector wages and weak governance have further limited progress.

13. Consistent with the "Low-Income Country under Stress" (LICUS) approach, IDA is accelerating its investment in the country's knowledge base. An expanded ESW program is being carried out, focusing first on the CFAA, Public Expenditure and Institutional Review

(PEIR) and Country Procurement Assessment Review (CPAR),² and then on analyzing barriers to progress in key sectors and developing a consistent medium-term institution building program. This work will create a foundation for future advice, technical assistance and lending that will be consistent with Tajikistan's financial and implementation capacities.

² In parallel, the Asian Development Bank (AsDB) is preparing a Governance and Institutional Review.

II. PUBLIC SECTOR BUDGET MANAGEMENT

14. The decision to make the transition from a centrally planned to a democratic, market orientated economy involves a radical transformation of public sector institutions, particularly the MoF, which occupies a central role in managing public finances. Indeed, a model based on central planning is ill suited to the needs of the market economy and, while the process of economic and political transformation has started, many vestiges of the old system remain.

Soviet Legacy and Progress to Date

15. Under the Soviet Union, the budget was a subset of national planning, and allocations were made largely in physical terms rather than on a monetary basis. Normative standards were developed for Government programs which formed the basis on which the budget operated. The role of production units was to execute the central plan.

16. However, independence has forced the Government to develop new tools and procedures for formulating, executing and evaluating the budget. In this respect, the long process of economic transformation and institutional adaptation has involved the gradual elimination of many practices and mechanisms of an economic system which was based essentially on barter. The fact that taxes were not collected, offset mechanisms were widely applied, and taxes were overlooked in exchange for goods and services, created unrealistic budgets and an inadequate framework for accountability in a large public sector.

Budget Comprehensiveness – The Legislative Framework

17. The Law of State Finances (2002) is a modern, well-constructed piece of legislation on budget processes. The following points are worthy of further discussion:

- Government is defined in a way that meets international standards. The State budget consists of a first level--the republican budget and State-targeted funds---while a second level consists of local budgets. There are no extra-budgetary funds and the only targeted-fund (from earmarked revenues) that remains is the Social Protection Fund (SPF).
- Budget documents cover the State and republican budgets and provide detailed estimates for the budget year, with current year implementation. They also provide information on forecasts for the next two years. However, coverage is incomplete in ways that undermine the budget's capacity to set policy and prioritize functions. First, donor funds (grants and loans) and related expenditures are not included. Second, the Public Investment Program (PIP) is prepared separately from the budget, is obtained from external sources and not channeled through the budget or Treasury. Third, it appears the division between ministries and State enterprises is unclear. The PRSP notes that some ministries are living off their enterprises, which suggests that significant funds are available to them outside the formal budget. In conclusion, the budget documents provide for a broad but not yet complete coverage of fiscal activity.

- Quasi-fiscal activities, particularly in the energy sector, are extensive and are only partly reported in the budget documents: The IMF estimates these activities are equal to 5½ percent of GDP. Further, governance, public oversight, monitoring and reporting mechanisms for SOEs are inadequate (see Section VI for a broader discussion of this problem).
- The SPF budget follows the same calendar as the rest of the budget and is confirmed by Parliament at the same time as the State budget. The latter includes the credits and grants from the international donor community, as well as debt service repayments. Budget reports also include all State borrowings, Government debt guarantees granted during the budget year, a list of all outstanding State debt and other debt management operations, and an overview of investments made from the State budget. Concern over the management and accounting for debt remains, although the Government is addressing these issues (see the section on cash and debt management below for a broader discussion on this point).
- The budget provides for a contingency fund,³ of which 2 percent is earmarked for a President's Reserve Fund,⁴ both of which are disclosed in the budget and reported in the annual execution report to Parliament.

Budget Planning and Approval

18. While Tajikistan's macroeconomic performance and fiscal discipline have improved in recent years, much remains to be done to ensure that public expenditures conform to strategic priorities and are efficiently utilized. Expenditure allocations across and within sectors do not yet reflect Government priorities; for example, the Poverty Reduction Strategy Paper (PRSP) describes the strategy for reducing poverty but it has not yet been effectively linked to the budget process. Also, within social sectors, inadequate attention is given to the relative contribution and effectiveness of different programs in alleviating poverty.

19. The budget process begins in April when the MoF Budget Department drafts instructions for preparing it. (In the 2002 budget cycle, the MoF issued final budget instructions to ministries, agencies and local units in June). The instructions indicate incremental increases allowed on programs and to budgetary organizations by economic classification. However, since budget formulation is primarily a distributive rather than redistributive exercise, the instructions are not linked to Government priorities or intentions for the period in question. The draft budget goes to the Government for review in September and the final budget is submitted to Parliament by November 1.

20. The Government developed its first medium-term budget framework (MTFB) for 2002-2004, which linked policy, planning and budgeting decisions in the planning and resource management cycle. As in other countries, fundamental changes in the budget process take time to implement. For this reason, while a major output of the first MTBF was the Budget Framework Paper, it received little attention in the MoF, was not broadly circulated in

³ The Government determines the size of the Contingency Fund, its distribution and use.

⁴ This reserve is spent by order of the President.

Government, and was not issued as an official document. Accordingly, the MTBF is not yet effectively integrated into the budget process.

21. It is vital that this process improves the link between Government policies and expenditures, and captures actual public spending intentions. One proposal, which was discussed in the past, is the formation of a Budget Commission (different from the Parliament's Budget Committee), appointed by Government to (1) oversee the development of medium-term revenue and expenditure forecasts, (2) approve budget instructions, (3) approve the aggregate resources that the Government expects to mobilize during the next fiscal year and (4) set expenditure ceilings for line ministries. These activities would occur in the early months of the budget cycle and be an integral part of the process. Shortly before the CFAA workshop in October 2003 the Government issued a decree setting up a Budget Commission along the lines proposed by the Report. During the CFAA discussions the Government recognized continued weaknesses in the budget planning process and requested further technical support from the donor community in this area.

22. Along with building its capacity at the central level, the Government also piloted the concept of program budgeting in the ministries of education, health, and agriculture and included performance indicators to reflect program outcomes. As in other countries, the line ministries' capacity to undertake this program has been limited. To date, little evidence exists of any tangible outcomes of these pilots. Thus, more training will be needed, along with disseminating the lessons learned from the pilot programs, until staff fully absorbs the concepts.

Budget Execution: The Role of Treasury

23. MoF's Treasury Department executes the budget. The Department includes the central Treasury, headed by a Director, which serves ministries and budgetary organizations financed from the republican budget, and 79 local treasury branches, which finance the local budget. Local treasuries report to the Director of the Treasury. According to the Law on the Treasury, the institution controls republican and local budget execution and prepares budget execution reports. In 2002, the Treasury processed approximately 220,000 payment requests: 41,000 of these averaged 8,600 somoni in the central Treasury and 179,000 averaged 1,000 somoni in local treasury branches.⁵

24. The central Treasury is divided into two divisions. One includes accounting policy, revenues and budget execution reporting, and the other involves expenditures (both financing and reporting) and internal audits. Each division is headed by a First Deputy Director. Regional treasuries are small and have separate divisions for managing expenditures and revenues/accounting.

25. Since 1999, the Treasury has operated a single treasury account through which all republican revenues and expenditures pass (the account is held at the NBT). At the local level, all revenues and expenditures are also handled through a treasury single account held either at

⁵ Source: Central Treasury of the Ministry of Finance.

local branches of the NBT or at the nearest branch of Amonat Bank, the State-owned savings bank.

26. The central Treasury financial management system is automated and based on one used in Kazakhstan. The system has automated access controls and appears to have adequate back-up arrangements. The Treasury, which plans to extend the system to local treasuries in the near future, should review the lessons in other countries in the region where some treasury offices have experienced slow system response times (delays due to poor communications' infrastructure), which resulted in delays in completing transactions.

27. The Treasury's role in accounting/financial reporting and internal controls is discussed in Sections III and IV, respectively.

Cash and Debt Management

28. The objectives of cash and debt management are to ensure that sufficient cash is available as needed to (1) meet commitments and make payments, (2) provide a predictable flow of funds to spending ministries, (3) to minimize the cost of borrowings, net of any returns of surplus funds and (4) control aggregate cash flows within fiscal, monetary and legal limits.

29. The MoF has overall responsibility for cash management. With regard to debt management, the role is divided between the ministry's External Debt Department and the Aid Coordination Unit (ACU), which was founded in 2001 and is under the Executive Administration of the President.

30. The use of the single treasury accounting system has imposed stronger control over cash at the aggregate level. However, there are weak systems of cash management or cash forecasting, which leads to arbitrary variations in payment dates and inefficient use of resources. The system of prioritizing payments is excessively centralized and requires daily decisions on the part of senior officials at the Treasury and MoF, including the Minister. The Law of Treasury contains no provision to regulate the cash flow process or borrowing procedures in the event of a cash shortage, or to invest when cash is abundant.

31. For effective budget execution, Treasury systems need mechanisms to effectively control commitments that can prevent the build-up of excessive expenditure arrears. In Tajikistan, the system of recording commitments is incomplete; employee salaries are not recorded in the system for example. This weakness allows spending units to take on commitments beyond their annual budget appropriations. There is no system to record past arrears in the system and the system needs to be modified to record and recognize them. Recording commitments will be particularly difficult at the local level, where systems are largely manual based.

32. Tajikistan's external debt has grown rapidly since independence. Until late 1997, when the country launched comprehensive economic reforms, the Government maintained trade relations with most former Soviet republics on the basis of annual inter-governmental agreements that covered most of the country's exports and imports. Under the agreements, the Government guaranteed import payments by state enterprises and effectively acquired the responsibility of financing the foreign trade deficit from the center. As a result, its public debt

rose to over US\$1 billion (100 percent of GDP) by the end of 2001. With Government revenues amounting to US\$160 million that year, the NPV of debt-to-revenues was 514 percent. This ratio is projected to stay above 250 percent up to 2007 and debt service is expected to absorb more than 40 percent of revenues. As a result, unless restructured, Tajikistan's external debt is not fiscally sustainable. This indicates that the resource envelope is going to be very tight in the immediate future and it is important that public expenditure policy calculates these constraints into the medium-term public expenditure framework.

33. The IMF has noted several instances of misreporting of external debt, which have affected disbursement conditionalities on the PRGF. The Government has acknowledged these problems and improvements were noted in 2002; authorities completed an inventory of government, government-guaranteed and state-enterprise debt and wrote to bi-lateral creditors to confirm its status. That said, much still needs to be done to improve the MoF's debt monitoring, analytical capacity and debt reporting systems. To this end, the MoF has been strengthening its Department of External Debt and is currently receiving technical assistance from the IMF.

34. To increase transparency, the Government began submitting quarterly reports to Parliament on its external debt, including debt service obligations and accumulated arrears. These reports were also incorporated into the Annual Budget Execution Report.

35. In 2001, a Presidential Decree established the Aid Coordination Unit (ACU) within the Executive Administration of the President. It is proposed that the Unit will (1) market public investment projects to development partners, (2) ensure resources are mobilized according to Government priorities and (3) serve as an information center with regard to current and future Government and other development partners' programs. The ACU, headed by a Director and supported by four technical staff, currently receives technical assistance from the AsDB.

36. Based on the CFAA team's discussions with Government officials during the main mission, there appeared to be considerable confusion on the role of the ACU and the MoF with regard to managing external debt. During the October 2003 CFAA workshop stakeholders noted that these problems had been resolved and the core responsibilities of the Ministry of Economy (MoE), MoF and ACU had now been clarified.

Budget Classification

37. After January 2000, the classification of fiscal accounts followed a system presented in the Government Financial Statistics (GFS) manual. The 2002 budget was prepared following these classifications, as was its execution report. In addition, data covering the consolidated central and local governments are now reported in the GFS Yearbook.

38. While the Government has been using the 14-sector GFS 1986 functional classifications, these did not anticipate the use of modern financial management systems or of organization-based budgets. Thus, the Government recently developed new improved functional classifications that will, for the first time, automate budget analysis at the level of the budgetary organization. This exercise will involve aligning the coding systems in the Budget and Treasury Departments; once accomplished, the linkage between the two systems

will save substantial time, especially in automating the quarterly distribution of finances to budgetary organizations.

Recommendations

39. To make the budget preparation process more inclusive, **the CFAA recommends** that the Government form a Budget Committee with representatives from the President's Office, line ministries, and regional administrations⁶.

40. **The CFAA supports** the MoF proposal to further computerize the local treasury network; however, **it recommends** that this be carried out with caution and consideration for the communications problems in remote parts of the country.

41. Systematic efforts are needed to record commitments and arrears in the Treasury system. **The CFAA recommends** that the Treasury develop procedures to record commitments through the automated expenditure controls already embedded in the system.

42. **The CFAA recommends** that a Cash Management Unit be set up within the MoF to improve the predictability of cash releases and communicate cash forecasts to line ministries. The recording and monitoring of debt, guarantees and state-enterprise debt needs to be improved and **the CFAA recommends** further capacity-building to improve the MoF's debt monitoring, analysis and reporting systems.

⁶ This recommendation was implemented between the submission of the draft CFAA and the finalization of the Report. Considerable technical assistance will be required to ensure develop the roles and responsibilities of the Commission within the budget planning process.

III. PUBLIC SECTOR ACCOUNTING AND FINANCIAL REPORTING

43. If the Government is to have the information it needs to make decisions, devise management controls and prepare budgets, it must have accurate fiscal reports on current and previous years' executed budgets. Because of the inadequate resources in the budget, particular emphasis has been given to revenue collection; also, weekly reports are being closely scrutinized at senior levels of Government. Due to the progressive development of the treasury system, accounting and reporting are more timely and effective, and plans for computerization of local treasuries in the near future should improve matters further.

44. At the same time, the production of more timely and reliable data on budget outcomes, and financial data being made available to the public (after appropriate external audit procedures have been followed) will increase transparency and accountability. The provisions in the Law on State Finances offer a strong legal foundation for improving the annual budget execution report. The first independently audited accounts, based on the 2002 budget execution, will be submitted to Parliament by October 1, 2003. However, given the limited technical capacity of the MoF, line ministries, budgetary institutions and SFCC, fulfilling the Law's requirements will present an enormous challenge.

The Soviet Legacy

45. Under the Soviet Union, the banking system served to maintain public sector accounts. The system, through its regional network, was relied upon not only for disbursing funds but also for government accounting--with accounting and bookkeeping systems parallel to those maintained by government ministries.

46. Many of the current practices in Tajikistan are holdovers from the old system. For example, a dual system of accounting is followed; line ministries use an accrual-based system for financial accounting and the Treasury uses a cash-based approach for budgetary accounting. While accounting in the line ministries follows a prescriptive rule-based approach that provides many financial details, its main purpose is to track expenses vis-à-vis budget provisions. The Treasury, with its cash-based approach, maintains records of all revenues and payments from a budget accounting perspective.

Accounting and Reporting by Line Ministries

47. The MoF is responsible for developing and issuing accounting and reporting guidelines together with formats for budget institutions. Accordingly, its Accounting Methodology Department⁷ issued the "Instructions on Accounting in Budgetary Institutions, 2000," which incorporate accounting rules, regulations and a chart of accounts. The rules are reasonably comprehensive although a number of deficiencies do exist, such as combining debtors and creditors in one account code.

⁷ This Department is responsible for developing and issuing accounting, auditing and financial reporting instructions and regulations in the public and private sectors.

48. The purpose of issuing an accrual-based accounting plan was to facilitate financial management-- particularly for liabilities. However, its requirements actually impose added burdens on budget institutions, which must then also maintain cash-based budget classification accounts that are reconciled with treasury records. In addition, given the limited capacity in the line departments, it is unlikely that much use is made of the information in the accrual-based financial statements.

49. Within the budgetary institutions, accounting is laborious and almost always done manually. These institutions are required to maintain several registers and produce numerous reports; thus, much time is spent reconciling figures instead of producing meaningful information that could be useful for management control and decision making. In general, officials in line ministries and budget institutions find the reporting process cumbersome and complex.

50. In terms of monitoring and evaluation, historically there has been little reporting on budget outcomes. Some efforts were made to develop performance indicators in selected ministries, but these were half-hearted and not linked to fundamental changes in institutional arrangements or the accountability of spending units.

Treasury Accounting

51. The Treasury has a difficult time in accurately reporting on budget execution due to a lack of computerization. Indeed, the paper-based systems that are used to collect data on budget implementation, particularly at the local level, do not give the Government the quarterly and annual budget execution reports it needs to supervise and monitor the budget plans. Fundamentally, the reporting exercise is time consuming and MoF staff does not have time to analyze reports so as to make financial management decisions.

52. The Treasury records transactions when it receives revenues or makes payments on behalf of a budgetary institution. However, as noted earlier, commitments are not completely recorded in the Treasury ledgers. Regional treasury offices maintain manual single-entry ledgers for each budgetary institution. The allocations are recorded against each account and disbursements are allocated against this amount. This manual system has the attraction of being simple but makes analysis and the consolidation process difficult and prone to error.

53. Banks conduct reconciliations on a daily basis and electronic data exchanges between the NBT and Treasury are planned for the near future. Treasury offices prepare periodic reports on the execution of revenues and expenditures. Revenue receipts are reconciled with the NBT each day and a report on revenue execution is sent to the Government each week. Tax revenues are reconciled regularly with the tax authorities and privatization proceeds are reconciled with the State Property Committee (SPC). Consolidated state revenue figures (including the local budgets) are prepared monthly. Execution reports for budget expenditures are prepared quarterly, as part of the consolidated budget execution reports.

54. The Treasury collates and consolidates reports received from the regional treasuries. The Law of State Finances requires the MoF to prepare quarterly reports on the State and republican budgets, which are submitted to the Government. Once approved, the Government

sends them to Parliament and the media, which publishes the reports no later than two months after the end of the quarter.

External Reporting

55. The annual report on the execution of the 2002 budget will be submitted to MN (the Assembly) in 2003. This is the first report that is required to comply with the Law on State Finances, which states that ministries, agencies and other budget organizations must submit their annual reports to the MoF within two months of the end of the financial year.⁸ Based on these reports, the MoF prepares the consolidated annual report on the execution of the State budget and submits it to the Government by May 1 (see Table 2 for the contents of the report). The report is comprehensive and should improve the overall level of Government transparency.

Box 2 - Contents of Annual Accounts of State Budget Execution

1. Revenues and grants received during the year
2. Functional and economic expenditures according to budget classifications, with comparisons between budget and actual outlays
3. The size of the budget deficit and financing
4. The beginning and end-of-year balances of the Treasury Single Account
5. An explanation of major discrepancies between actual budget allocations and the approved budget
6. A report of all state borrowings, government debt guarantees granted during the budget year, a listing of all outstanding State debt and other debt-management operations
7. An overview of State investments
8. A report of expenditures from the President's Reserve Fund and the Contingency Reserve Fund

56. The Law requires the Government to submit the Annual Accounts to the Parliament and the SFCC by June 1. The SFCC is required to submit its audit of the annual execution report to the President, Government and Parliament by October 1. The CFAA anticipates a number of challenges in the process used to prepare accurate and timely annual financial reports. First, the quality of financial information, particularly from the line ministries, is poor; thus, the MoF will need to develop systems and procedures to monitor the quality and accuracy of financial information (largely produced on manual systems) prior to the consolidation done by the MoF. Second, systems need to be introduced to capture data on Government borrowings, guarantees and investments. As mentioned earlier, databases are being developed to improve performance in this area. Third, financial audits of the execution reports are new to Tajikistan.⁹ The SFCC needs to develop the capacity to conduct these audits according to

⁸ Art. 58 of the Law.

⁹ Experience elsewhere in the region has shown that supreme audit institutions (SAIs) do various discrete audits according to a work-plan during the year, and submit an annual report on their activities

international standards. Finally, the Law improves the quality and detail of the financial information available, but its presentation needs to be improved in order to reflect user requirements. For this reason, public sector reporting requirements need to be reviewed regularly to ensure that the needs of the public and other users are fully met.

Integration of Public Sector Accounting

57. As is common in other FSU countries in transition, the lack of consistency between budgetary reporting and public sector accounting rules needs to be addressed. This is a challenging process which involves a clear vision as to how the rules will evolve in the medium-long term. A start would be to integrate the two coding systems, the budget classifications and Chart of Accounts (COA), so that all spending units are brought into a single classification system and COA. Along with ongoing work in the private sector (see Section VIII), the CFAA recommends that the Government should consider the IFAC IPSAS's, which are an important international effort to improve government financial reporting (see Box 3 below).

Box 3 - International Federation of Accountants (IFAC) – Accounting Standards for the Public Sector

- The IFAC Public Sector Committee is developing a set of International Public Sector Accounting Standards (IPSASs), based on International Accounting Standards (IAS). IPSAS's cover both cash and accrual-based accounting.
- Under cash accounting, the IFAC released "Financial Reporting under the Cash Basis of Accounting" in January 2003, which highlights the information to be disclosed in the Statement of Cash Receipts and Payments.

Recommendations

58. **The CFAA recommends** that a multi-user training program be provided on financial management information to aid in decision-making. Such training should be offered to various users, including civil servants and parliamentarians.

59. **The CFAA recommends** that the Government create a working group of experts to review the long-term requirements for its financial management system, including reforms to integrate accounting in Treasury and budgetary institutions. The working group should consist of participants from the MoF, the President's Office, line ministries, Parliament and the SFCC, with support from international experts.

60. Preparation of the 2002 annual, independently audited budget execution report is an important learning exercise for the Government, MN and SFCC. Thus, **the CFAA recommends** that the Government convene a working group that includes international experts to evaluate the preparation and attestation processes of the 2002 Report.

to the parliament along with the annual budget execution report. They do not actually audit it, nor do they express an opinion on it.

IV. INTERNAL CONTROL AND INTERNAL AUDITING

The Soviet Legacy and Transition to Date

61. Under the Soviet Union, various budget controls were applied. These included: (1) checks and balances within each ministry, (2) verifications exercised by the Central Bank and the State banking apparatus, which were in charge of disbursement and transfer of funds, (3) inspections exercised by the MoF's Directorate of Financial Control and Revision, and (4) ad hoc controls by the Party. Control activities monitored conformance with decisions made at higher levels on the allocation of financial resources and the direction of physical operations under the economic plan.

62. During the transition period, the wide range of institutions that had been responsible for control and investigation practices in Tajikistan were substantially weakened. As a result, practices such as paying illegal salaries (by maintaining fictitious posts) and the widespread abuse of budget funds for business trips and office supplies had become commonplace. Also, informal payments are often made to state employees (to compensate for the very low official salaries) at all levels of government and are a serious problem.

63. Since it is well understood that internal controls are seriously defective in many institutions, it will be difficult to develop a modern internal audit function. Nevertheless, a new institutional framework is evolving. The Financial Control and Revision Unit (FCR) was disbanded in 2001 upon the creation of the State Financial Control Committee and Treasury Internal Audit Department. These bodies should have clearly defined functions. Given the evolving nature of activities of both SFCC and Treasury's Internal Audit Department, there is a need for further improvement towards bringing their functional responsibilities and accountabilities to internationally accepted standards.

64. Internationally, a consensus on the approach to government internal controls¹⁰ has been evolving and are now seen as a management tool to assure that objectives are being achieved. To develop systems that no longer review individual transactions but instead analyze the quality of an organization's management controls and procedures, the Government will need technical assistance. The challenge will be for Government to develop a new professional orientation that is seen as a management tool focusing on service delivery and diagnosis, instead of merely imposing rules and sanctions.

Legislative Framework

65. According to the Treasury Law, the central treasury and local treasury branches are responsible for controlling the budget execution and spending process. Their responsibilities include applying controls over republican and local budget execution, preparing reports on State budget execution, and issuing instructions as well as accounting and reporting forms on

¹⁰ For example see "Internal Control: Providing a Foundation for Accountability in Government" – INTOSAI, 2001.

the budget execution. However, the Treasury Law does not address the roles, functions and accountabilities of a modern internal control framework.

Treasury Internal Audit Department

66. Once the Treasury was created, a more disciplined public financial management system was developed, supported by the Treasury's Internal Audit Department (IAD); this unit covers both the republican and local budgets. Its activities, which involve on-site inspections, focus mainly on assessing compliance with the budget law and determining if funds are misused (for example, funds being allocated to inappropriate purposes).

67. The IAD has a staff of 25--seven in the Central Treasury and 18 in regional treasuries. However, the quality of the staff dropped when many former members left to join the new SFCC, due to the reorganization of control functions in 2000/2001. In addition, there are some fundamental problems with the structure of the IAD. For example, the Treasury Manual envisaged the IAD Director to be directly subordinate to the Director of the Treasury; at present, however, the IAD is managed by the First Deputy Director of the Expenditure Division and the IAD Director is also acting as head of a payment unit within the Treasury. Unfortunately, this management structure does not allow for an objective and independent internal audit function. Thus, the structure needs to be revised according to the guidelines defined in the Treasury Manual.

68. Besides staffing and structural difficulties, the IAD is limited in the scope, number and effectiveness of its control activities by insufficient human capital and poor information technology. As it is a new department, it could benefit from exposure to the work of a well-established internal audit institution, to learn the latest audit techniques.

69. IAD activities are based on an annual work plan that sets up audits of all budgetary organizations once a year. When violations and misuse of funds are identified, the Deputy Minister of Finance writes to the budgetary organization. If the unit agrees with the IAD assessment, the letter is countersigned by the organization's director and its budget allocation is reduced. The IAD then submits a quarterly report to the MoF, listing the number of audits and violations as well as the amount of misused funds and those returned to the budget.¹¹

Implementation Issues and Concerns

70. Current legislation fails to adequately address the role of internal controls and internal audits within Government. First, it does not define and set accountabilities for maintaining the internal control framework. Thus, it needs to identify the role of spending agencies in maintaining adequate financial management systems, including internal controls.

71. Second, apart from the small IAD in the Treasury, the Government has yet to address the role of internal audits in the public sector. With its present governance problems, the most important objective should be to ensure compliance with the financial laws and regulations.

¹¹ The CFAA Team was informed that the 2002 activities identified SOM1.9 million of misused funds, of which SOM1.2 million was returned to the budget.

This could be achieved if an internal audit function were developed within MoF, with a special cadre and concentration of scarce audit resources.

72. Third, once the IAD's structural issues are resolved, the MoF needs to develop a professional internal audit function for the public sector, using international standards and practices. The Institute of Internal Auditors' Framework for Standards for the Professional Practice of Internal Auditing (SPPIA) includes a Code of Ethics, Glossary, Attribute Standards, Performance Standards, Implementing Standards, and Practice Advisories that offer detailed guidance and a practical interpretation of the standards (see Box 4 for a summary of the standards¹²).

Box 4 - Standards for the Professional Practice of Internal Auditing (SPPIA)

Attribute Standards

1000 Purpose, Authority and Responsibility
1100 Independence and Objectivity
1200 Proficiency and Due Professional Care
1300 Quality Assurance and Improvement Program

Performance Standards

2000 Managing the IA Activity
2100 Nature of Work
2200 Engagement Planning
2300 Performing the Engagement
2400 Communicating Results
2500 Monitoring Progress
2600 Management's Acceptance of Risks

Implementing Standards apply the attribute and performance standards to specific types of engagements (for example, a compliance audit, fraud investigation, control self-assessment etc).

Source: *The Institute of Internal Auditors*: www.theiia.org

Recommendations

73. **The CFAA recommends** that the arrangements for organizing the Treasury IAD be revised according to the Treasury Manual; also, that the Government prepare a strategy for developing public sector internal audits that covers (1) staffing and skill requirements, (2) audit approaches and methodology and (3) structural/institutional arrangements.

74. **Recommendations** with regard to cooperation between the IAD and SFCC are proposed in Section V.

¹² As the CFAA study is not exhaustive, it should not be considered a formal review of the internal audit system's compliance with SPPIA.

V. EXTERNAL OVERSIGHT OF PUBLIC FINANCIAL MANAGEMENT

75. It is generally recognized that a sound way to increase Government accountability is to oversee the manner in which it and other public institutions raise and spend public funds. This section reviews the role, responsibilities and effectiveness of the State Financial Control Committee (SFCC), the Majlisi Namoyandagon (Assembly) and its committees.

A. STATE FINANCIAL CONTROL COMMITTEE

76. The establishment of the State Financial Control Committee (SFCC) in 2002¹³ as the country's Supreme Audit Institution (SAI) filled an important gap in the financial accountability framework. While the law defines and regulates the SFCC's activities, the Committee has considerable freedom to choose what and how to audit. The Committee also develops its own methodology, standards and manuals. However, some fundamental problems surface with respect to its role as set out in the Law, and are discussed below.

Legal Framework – Lack of Independence from the Executive Branch

77. Unambiguous independence from the executive branch is the sine qua non of objective and effective external auditing. Measured against this standard, the SFCC fails the test as a fully independent entity, since it was established by and reports to the President. Further, the President (1) appoints and can dismiss the chairperson, (2) approves the regulations, number of staff and total amount of salaries and (3) is the sole recipient of its detailed quarterly activity reports.

78. Although varied SAI models are evolving in the former Soviet Union, a particular weakness of the SFCC is the lack of transparency in its reporting relationships. A clearer link between it and the MN could help correct this problem, as well as having more transparent reporting procedures —thereby increasing its accountability. These changes would also support the MN in its oversight role of the Executive branch (see Section B, below, for a more detailed discussion).

Scope of Responsibilities

79. Pursuant to the Law, SFCC's primary role is to supervise and audit State transactions, the use of State budget and funds, loans received, guarantees, grants, humanitarian assistance and State property, and report its findings.

80. The Committee's scope of activities is broad and includes supervising and controlling the (1) revenue and expenditure parts of the republican and local budgets, (2) use of State funds and property, (3) use of gold and foreign currency reserves, (4) legitimacy and timeliness of the movement of public resources in State and commercial banks and (5) use of credit

¹³ The SFCC was created by Presidential Decree and the legal and organizational framework established in the Law on State Financial Control, 2002.

resources and external debt. It must also analyze the draft revenue and expenditure parts of the State budget and identified deviations from the indicators of the State budget and SOEs.

81. Given such a large range of activities, it is important that the SFCC does not lose sight of its primary function, which is to examine ex-post if resources have been used for the purposes intended. Thus, the SFCC needs to evaluate its capacity to deliver on the broad mandate envisaged within the Law. For example, the SFCC is required to analyze the formation of the revenue and expenditure budget. According to the SFCC, in practice, they do not get involved during the budget formulation process, but review the draft of the already agreed budget. While some SAIs in Western Europe help legislatures oversee the budget in this manner, there is a danger that this activity will take capacity away from the SFCC's core function.

82. Traditionally, parliamentary Public Accounts Committees (PACs)—named the Economy, Budget, Finance and Taxes Committee in Tajikistan—advise governments on the budget and are not allowed to participate in any activities they will later audit. Instead, they are involved in the budget cycle only once governments report to the legislatures on budget execution: The concern is that an SAI's involvement before an agreement on the budget is reached would compromise its ability to independently assess the use of budget funds. Thus, in Tajikistan, any involvement by the SFCC in the budget discussions before this period would inevitably politicize its audits.

83. For this reason, the SFCC's role should be limited to ex-post auditing; responsibility for providing the President and the Legislature with expert opinions on budget preparation, revenue and expenditure forecasts, as well as analyzing draft laws, should be the role of the Legislature's Budget Committee. Further, any direct contact between the parliamentary committees and SFCC should be limited to the latter's responding to specific requests for advice only after the draft budget law and interim reports on budget execution have already been reviewed.

Activities and Procedures

84. One of the SFCC's main activities is to prepare the work plan for its activities. Such plans are submitted to and approved by the President, who may later authorize any changes. In addition, when requested by a law enforcement agency, the SFCC Chairman may also approve a change.

85. Based on its work plan, the SFCC conducts its control activities. The size and composition of teams making on-site visits depends on the complexity and size of the assignment. Following the visits, SFCC experts prepare reports that list financial or other violations, and include monetary values. The SFCC Chairman submits the findings (by letter) to the entity, which has a month to respond, describing the measures taken to correct violations. In serious cases, the Office of General Prosecutor may also be contacted to take further action.

Dissemination of Audit Findings

86. Every quarter, a summary of SFCC activities and measures taken is prepared by each sector department and submitted to the Department of Organization and Methodology, then to the Chairman, who approves it and sends it to the President. Unfortunately, the dissemination of the SFCC's findings lack transparency. Besides the quarterly report to the President, the SFCC is only required to submit a summarized annual report on the results of the audits to the Majlisi Namoyanagon (MN).

Staffing

87. The SFCC has 157 staff, 94 of whom are at central offices and the others at four regional offices. Staff are organized into four divisions, depending on which units they control: (1) local budgets, (2) joint ventures and joint stock companies with Government participation, (3) line ministries and State committees and (4) SOEs. In addition, it has two support departments: (1) Organization and Methodology of Financial Control and (2) Information Technology.

88. While most SFCC staff have a strong background in control¹⁴ activities, they have had little exposure to modern public sector auditing techniques. Thus, its auditors would benefit from substantial training and on-the-job experience with international audit procedures.

Audit Methodology

89. As with other SAIs in the former Soviet Union, cultural and historical attitudes towards State control functions shape the SFCC's methods. Based on past practices, the Committee reviews documents pertaining to the executed budget, which involves analyzing payment documents, verifying them and comparing them with MoF's and the budgetary organization's own accounts. However, many of these activities duplicate functions more properly carried out by Government units involved in internal audits (see the section on links between external and internal audits, below).

90. The SFCC investigates documents (assessing the regularity of administrative functions from a formal and substantive viewpoint), and focuses on compliance (determining if corrective actions adhere to rules and regulations). The 2002 Law of State Finances now requires the SFCC to report on the performance of the Government budget, submitting its findings to the President and MN no later than nine months after the year's end. However, the SFCC needs technical assistance towards conducting audits of financial statements in accordance with International Standards on Auditing.

91. The SFCC is required to issue a general audit assurance on the Government's annual execution report; this step is vital to achieve transparency and accountability within Government operations, as well as public confidence. To achieve these aims, the SFCC needs to improve its financial audits and expand them to cover annual execution reports of individual

¹⁴ Many SFCC staff joined from the Department of Financial Control and Revision in 2002.

Government entities, in order to strengthen the general audit assurance on the overall execution report.

92. The narrow scope of the SFCC control activities is reinforced by its own measurement of performance, which focuses on identifying and quantifying misuse of public funds and ensuring that they are returned to the budget. While this task is crucial, inspectors have little incentive to identify broader issues such as weaknesses in internal controls or potential improvements in administrative efficiency. If these issues were addressed, it would improve the long-term development of budget organizations and could be used as a measure of institutional performance (see Box 5).

Box 5 - Measurement of Impact in SAI – UK National Audit Office

The UK National Audit Office (NAO) measures the impact of its work by calculating the number of significant changes made by audited bodies as a result of NAO recommendations, annually. For example, in 1999, about 1,700 significant changes followed financial audits and another 550 evolved from value-for-money work. The Office also estimates that its work led to savings or economies of approximately £140 million and £353 million, in these areas, respectively.

93. Senior SFCC management has observed that the Committee should retain a percent of resources returned to the budget. However, if this practice were adopted, it would provide a perverse incentive for auditors to maximize receipts rather than focus on the primary and boarder objectives of public sector auditing.

Links between Internal and External Audits, and other State Supervisory Activities

94. CIS countries have found the task of rationalizing institutional controls and audits to be extremely challenging. During the CFAA Mission it became clear that the donor community needs to put considerable additional effort into explaining internationally accepted norms of the role of internal control, internal audit and external audit in the public sector. In Tajikistan, there is still a need of improving interface between the MoF's Internal Audit Department (IAD) and the SFCC. Thus, the goals should be to (1) coordinate the activities of both and (2) reinforce the process through which policies, procedures and practices regarding public financial management are made adequate and sound.

95. Internal and external audits are complementary and both should follow a risk-based approach. The task of the former is to exercise preventive control, ex-ante, and current control over an organization's operations. The latter's task is to (1) provide an ex-post assurance that financial statements accurately present an organization's financial position and results and (2) detect systemic weaknesses and associated risks in a professional manner, listing practical recommendations to correct them.

96. To be more effective, the SFCC should be able to monitor the IAD's work, but it should not have the primary responsibility for this task or duplicate IAD activities. However, communication between the two bodies should be improved so as to build cooperation, at the

same time as the areas of specialization and prerogatives of internal and external audits are recognized.

B. LEGISLATIVE OVERSIGHT OF THE EXECUTIVE

Constitutional and Legislative Background

97. The Constitution provides for legislative oversight of the Executive branch in several ways. (1) The Government presents its draft budget law to the Majlisi Namoyanagon (MN), as Article 60 states that the MN will supervise its implementation. (2) The 2002 Law of Government Finances states¹⁵ that MN will approve the Law on the State Budget for the next financial year, exercise control over budget execution, analyze its use by recipients, and approve the report on budget performance for the previous year. (3) The Law requires that before November 1,¹⁶ the Executive must submit the budget to the MN and include forecasts for the next financial year (prepared according to functional and economic classifications), with details as to the funding of any budget deficits. (4) Government quarterly execution reports and an MoF monthly report on revenue execution must be provided to the MN. (5) The Government must send the MN a final account of the previous year's budget execution by June 1.¹⁷ (6) The SFCC must send its report on the performance of the State budget to the President, Government and the MN before October 1.¹⁸¹⁹ The SFCC will submit its first report for the execution of the 2002 budget in 2003.²⁰

Checks and Balances within Parliament

98. Parliament has a Budget Committee which reviews the draft budget law. Other MN sector committees also discuss areas of specific interest regarding budget submissions and the Budget Committee summarizes all comments at a plenary session of Parliament. Key officials from the President's Office, MoF and line ministries are invited to attend these sessions.

99. At present, the Budget Committee operates with seven representatives and a small support unit. However, the Committee readily recognizes its current capacity to conduct detailed reviews of the budget submissions is extremely limited; it does not have enough specialized staff to research and analyze both the budget proposals and execution reports. For this reason, the Committee should explore creating a fiscal analysis office in Parliament, staffed by economists and financial experts. It would also be useful if the Committee had more exposure to similar entities in other countries, so as to adapt international best practices to Tajikistan.

100. The current legislative framework needs to be improved, since the MN does not have enough power to exercise its constitutional role of monitoring the budget's execution. It is the Government's responsibility to ensure that executed funds are properly managed and

¹⁵ Article 27.

¹⁶ Articles 39 and 40.

¹⁷ Article 58.

¹⁸ Article 60

¹⁹ At the time of finalizing the CFAA the 2002 attestation report was overdue.

²⁰ This is discussed in greater detail in Section IV.

weaknesses eliminated, and the MN's task is to ensure that the Government takes appropriate actions. For the MN to adequately fulfill its oversight role, there must be greater interaction between it and the SFCC. Currently, the Law does not require Parliament to approve the SFCC's annual report on budget execution, nor does it empower Parliament or its committees to summon the Chairman or SFCC staff to meetings to discuss the audits or budget execution reports.

Recommendations

101. To strengthen transparency and public accountability, the **CFAA recommends** an approach to (1) build capacity within the SFCC, (2) eliminate weaknesses in the Law of State Financial Control and (3) improve MN's capacity to review the Executive branch's output.

102. To improve SFCC's capacity, **the CFAA recommends** that in the short term, a program be designed that would (1) strengthen the staff's financial attestation audit and diagnostic skills, (2) expand compliance audits beyond cataloging errors so as to identify systemic problems and (3) describe ways to improve the management of public resources. Until now, the SFCC has had no substantive technical assistance; thus, if it entered into a twinning arrangement with a well-established SAI, its staff could learn the latest approaches in government audits.

103. Section IX of the CFAA discusses SFCC's role in auditing projects financed by the World Bank and other IFIs. **The CFAA recommends** that SFCC staff be trained in the Bank's project-specific operational policies and procedures (including financial management, disbursement and procurement) so as to perform their work more effectively.

104. The Bank's Country Procurement Assessment Report (CPAR) found that SFCC staff lack the necessary skills to conduct procurement audits. Thus, **the CFAA endorses the CPAR recommendation** to offer training to SFCC staff to deepen their understanding of procurement issues and audits.

105. To ensure quality, **the CFAA recommends** that, besides establishing a dedicated organizational unit in charge of internal quality control, the work of the SFCC should regularly be reviewed by another SAI.

106. Further, **the CFAA recommends** that Parliamentary oversight over SFCC activities should increase. In the long term, the recommendation is to subordinate the SFCC to the Legislature. (consistent with the positioning of Supreme Audit Institutions in a democratic state). Given the country's background and existing political constraints, any actions with respect to increasing Parliamentary oversight should be taken only after a detailed analysis of the current SFCC roles and responsibilities is performed.

VI. STATE-OWNED ENTERPRISES

Overview

107. Tajikistan largely retains a system of public administration based on the former Soviet model: It involves small ministries that manage large numbers of subordinate bodies, including State Owned Enterprises (SOEs) and a broad network of sector units at the oblast and raion level. Under this system, ministries focus on control tasks and routine administrative functions. Few incentives exist for ministries to relinquish control over SOEs, which provide both income and prestige.

108. According to the SFCC, despite the ongoing privatizations, 583 SOEs remain, with different percentages of Government ownership. About 38 percent have over 200 employees.

Government ownership	No. of SOEs	%
Under 25 %	58	10
25% - 99%	467	80
100%	58	10
Total	583	100

109. The SOEs are constituted under charters or closed joint-stock companies. Except for two companies, Tajik Aluminum and Vastok Redmek, all SOEs report directly to their designated line ministries.²¹ Legally, they are autonomous bodies, but the respective ministries appoint directors and key personnel. Thus, in practice, SOEs are quite regulated and experience a high degree of ministry interference.

The Importance of Quasi-Fiscal Expenditures

110. SOEs are quasi-fiscal entities, legally separate from the Government, and are not included in the official budget. However, they affect the budget in several ways, as they receive Government equity injections, loans and subsidies, repay loans, and pay interest, taxes and dividends.

111. In the utility sector, given the collapse of personal incomes and the lack of structural reforms, significant quasi-fiscal expenditures have arisen. Energy companies, as a result of below-cost tariffs and poor collection ratios, have recorded large financial losses and built sizeable arrears. While this has shielded the public in the short term, it has caused the main utilities' capital stock to deteriorate. In turn, this has created power outages and problems with gas delivery infrastructure, which affect the public welfare and private sector development. The IMF estimates that quasi-fiscal expenditures are 6-10 percent of GDP, coupled with a large stock of arrears.

²¹ TADAZ and Vastok Redmek report directly to the Office of the President.

Financial Management

112. SOEs submit monthly, quarterly and annual data to the ministries on key quantitative indicators. Also, they produce annual accrual-based financial statements, including income and expenditure accounts and balance sheets, which are subject to the same accounting rules as private sector corporate financial statements. The reports are supplied to the line ministries, the MoF and the State Committee of Statistics. Such information is used primarily for statistical rather than managerial purposes.

113. The SOEs maintain records and prepare financial statements according to the Tajik accounting and tax system. Some steps have been taken to adapt their accounting standards to International Accounting Standards (IAS) but, even in the largest SOEs, the capacity to understand and develop modern accounting and financial management systems is still quite low.

Internal Controls, Internal and External Audits

114. The issues raised in the section on internal controls also apply to the SOEs: Corporate governance is weak and managers frequently override internal controls.

115. All SOEs with Government ownership above 25 percent are subject to an SFCC compliance audit every two years. An average audit lasts about 20 days, involving two or three specialists. While copies of the audit summary are sent to the SOE managers and line ministry, detailed findings are not published or subject to legislative scrutiny. Besides the mechanisms described above, no other legislative requirements exist to audit the SOEs. The policy matrix of the SAC2 conditionalities required that, from 2001 onwards, ISA audits should be carried out by firms acceptable to the Bank for TADAZ, Barki Tajik and Tajik Air. The same requirement has been introduced for Tajik Telekom (from 2002), Tajik Rail and Tajik Gas (from 2004).

116. As discussed in Section XIII (on enterprise accounting and auditing), **the CFAA recommends** that the financial audit requirement should be introduced gradually. The largest SOEs should be subject to international accounting and audit requirements and the results of these audits should be available both to the public and Parliament.

117. Because of its overall significance to the economy, financial arrangements within TADAZ are discussed in Box 6.

Box 6 – Case Study - Tajik Aluminum Plant – TADAZ

The Company. TADAZ is a 100 percent state-owned-enterprise incorporated in Tajikistan. In August 1991, ownership of the company's plant was transferred from the Soviet Union to Tajikistan.

TADAZ produces aluminum. In 2002, production totaled 307,000 tons with a sales value of around US\$405 million. More than 98 percent is exported to a limited number of customers incorporated overseas, under exclusive contractual agreements. The ownership of these companies is unknown.

TADAZ, which employs about 13,000, is a major player in the economy. It is the largest enterprise and accounts for 35 percent of electric energy consumption, 30 percent-40 percent of exports and a significant share of GDP. Production is concentrated in a single mill, constructed in 1975.

The Company's assets constitute the national property of Tajikistan, however TADAZ has the full right to use them and distribute whatever profits are produced. Neither TADAZ nor the Government are liable for the other's obligations.

One of the actions the SAC2 Action Plan (April 2002) proposed was to convert TADAZ into a joint stock company. The action is still pending.

Management structure and corporate governance. The Company is not governed by a Board of Directors or any other type of executive committee. Instead, it is under the sole command of its Director, who reports only to Tajik President at a monthly meeting.

Since SOEs normally report to their respective line ministries, TADAZ's arrangement is an exception. The only other exception involves the Vastok Redmek, a company that produces precious metals.

The company's operations are subject to numerous checks by various Government control bodies. However, the company does not report to Parliament, except during the approval of the State budget when the company's chief accountant provides information and reports to the Budget Commission, upon request.

Financial management. TADAZ maintains its records and prepares its financial statements in the national currency (somoni) according to the Tajik accounting and tax legislation.

It was only in 2000 that the Company first presented financial statements, prepared according to International Accounting Standards (IAS). SAC2 required TADAZ to have an audit of its IAS statements conducted according to International Standards of Audit (ISA).

The financial statements issued under Tajik accounting regulations differ from the 2000 IAS financial statements audited by an international audit firm. The main variations involve: (1) accounting for inventory, (2) valuation, depreciation and impairment of property, plant and equipment, (3) foreign currency translations, (4) deferred income taxes, (5) allowances for bad debts and (6) recognition of revenues and expenses.

IAS skills and capacity in the company are still very limited. The SAC2 action plan also required the full introduction of IAS accounting and the re-evaluation of the Company's fixed assets and inventory. As for the former, it is unclear if TADAZ management intends to fully comply, while the latter action has not yet been introduced.

Audit arrangements. The SAC2 Policy Matrix required that from FY2001 TADAZ prepare IAS financial statements to be audited by an audit firm acceptable to the World Bank. Initially, a firm of auditors acceptable to the Bank was contracted to audit the FY2000 and

FY2001 financial statements. During the audit of the FY2000 financial statements, a dispute arose between the auditors and the Company, and TADAZ dismissed them before they issued a final report. The Company claimed this was due to the audit firm's unsatisfactory performance. The auditors claimed the main reason was TADAZ's management's dissatisfaction with the related party transaction disclosures proposed by the auditors.

The Company then appointed another auditor to complete the FY2000 AND FY2001 audit, although this firm was not listed among those auditors qualified to audit World Bank-financed projects. In December 2002, on an exceptional basis, after they had completed their audit field work on TADAZ, a Bank team reviewed this firm to assess if it had met the Bank's minimum requirements. Upon an examination of working paper files related to the audit of TADAZ the Bank team concluded that this firm was not acceptable to the Bank.

Going concern and related-parties transactions. According to the audit report issued on the financial statements for FY 2000, "the company had an accumulated deficit of US\$529 million and net current liabilities of US\$158 million. In addition, the company is heavily reliant on a single group of companies as a supplier of material, purchaser of finished goods and provider of credit."

Recommendations

118. To enhance the business climate and the country's economic development, it is vital to improve corporate governance in private sector enterprises and SOEs.

The CFAA recommends the following:

- All SOEs should be constituted as joint stock companies with Boards of Directors with clearly defined roles and responsibilities;
- SOE financial statements should be prepared under IAS and piloted for the largest companies identified in SAC2. The statements should be audited each year by a firm acceptable to the Bank with the audits conducted according to ISA;
- The Government should create a unit to monitor SOEs' quarterly financial flows, debt and arrears, as well as financial and other performance targets. In addition, the unit should oversee governance arrangements, including the appointment of Directors and the publication of regular financial information, audited financial statements and company charters. The monitoring unit would focus initially on the largest SOEs.

VII. LOCAL GOVERNMENT AND COMMUNITY-LEVEL INSTITUTIONS

Background

119. The country's Constitution establishes the concept of local autonomy and addresses the organization and functions of local governments, which consist of three tiers.²² The first is the oblast level, which includes the City of Dushanbe, Khatlon, Sugd and the autonomous oblast of Gorno-Badakhshan, all under the central Government. The second is the district level, which includes cities and raions under the oblasts, four districts in Dushanbecity as well as 13 *raions* directly under the republican budget. The third is the village and community level in rural areas, which includes the *jamoats*, local councils composed of several villages. Local government expenditures are significant, accounting for about a third of total State budget expenditures. A schedule of the execution of the revenues and expenditures of local budgets is detailed in Annex 3.

120. Tajikistan consists of the capital city, three oblasts and 62 raions (58 rural raions and four raions in Dushanbe), with a total of 22 cities, 47 towns, 356 jamoats and 3,500 villages. While not recognized in the Constitution or the Law of Self Government in Towns and Villages (1994), each village has a *mahalla* or informal decision-making body.

121. The first local council elections since the civil war were held in 2000 and council members were elected for five-year terms in the oblasts, Gorno-Badakhshan, cities and raions.

122. Local executive authority at the second and third tiers is exercised by the chairman of the local administration (*khukumat*), who represents the central Government. *Khukumat* chairmen are appointed and dismissed by the President and approved by their respective councils. At the first level of government, the chairman of the jamoat is nominated by the city or raion chairman and elected by the jamoat.

123. Overall, the Government is highly centralized and the extent of local government authority is weak. To address this, the Government is working on a new law on local government which seeks to better define the roles and responsibilities of the different levels of government, including the informal community-level institutions. See Box 7 for a description of some of the fiduciary aspects of community development.

²² For a better understanding of Tajikistan's geography, see the map in Annex 2.

Box 7 – Community-based activities in Tajikistan

The World Bank's 2003 Country Assistance Strategy (CAS) recognizes the importance of community-based activities to improve support to public infrastructure and services, especially health and education. Given the major implementation weaknesses in central and local administration identified in a number of previous studies, community programs are seen as a way of empowering poor people and improving governance, in order to ultimately enhance social and infrastructure services.

Many donors and NGOs already support community development in Tajikistan. Among the most prominent are the Aga Khan Development Program, Counterpart, Merci Corps, UNDP and USAID. The World Bank's own experience is primarily through the Tajikistan Social Investment Fund project. However, no coordinated effort exists that could increase these donor activities in order to reach most of the poor.

A number of obstacles to expanding the process are:

- Lack of commitment from central and local government. From the Government perspective, community programs are a threat to the status quo. This problem is exacerbated by the fact that there is little dialogue between the administration and donors during the development and appraisal of interventions. Thus, donors need to involve the Government more in the design, monitoring and evaluation of programs.
- Inadequate legal framework. As discussed elsewhere in this section, the roles of the various levels of government lack clarity; in addition, resources, particularly at the local level, are extremely thin. Control is highly centralized and community leaders at the jomoat and khukumat level have minimal roles in representing their communities.
- Problems with the flow of funds. Donors cite weaknesses in the local banking and treasury systems and a major implementation difficulty, particularly in rural areas (as documented elsewhere in the CFAA). One donor group described the process of training local banks in basic procedures, such as preparing bank statements. Other donors avoid the system completely and rely heavily on cash-based systems that they control. Also, there is a serious problem of counterpart funding in the poorest rural communities.
- Lack of a longer-term approach. Most community programs are designed for a two-four year period, which is not long enough to make a significant and sustainable impact. Thus, donors need to fashion programs that give sufficient time to develop and scale-up initiatives.

Local Government Budgets

124. Local budgets refer to the budgets of oblasts, cities and raions. Budget preparation is a highly centralized and structured process, with the MoF playing the dominant role: It instructs the sub-national units on preparing their budgets, providing estimates of inflation and other factors that the units need during the process.

125. Raion/city levels prepare their budgets based on inputs and cost estimates. Much is entered manually, including calculations and summaries; as they do not have computers, the process is extremely time consuming.

126. Once the raions/cities estimate their budgets, they defend them at the oblast level. At this point, changes can be made based on revenue and expenditure estimates and the overall level of funds available. The process repeats from the oblast to the national level, with the MoF reviewing the oblast submissions.

127. Oblasts can defend their estimates before the Budget Commission,²³ which can include the Minister of Finance, Deputy Minister, department heads within the MoF, Ministry of Taxes and Revenues, State Statistical Committee and representatives of other ministries.

128. Despite the high degree of centralization in this process, local governments have some flexibility to set tax rates within limits defined and approved by the MoF. Local councils can use revenues collected in excess of the revenue estimates and can reallocate some funds, although this excludes protected items such as salaries, social security, stipends and pensions.

129. Inter-governmental transfers basically involve reallocations from donors to recipient regions through revenue sharing of taxes specified in the budget law. The local units that do not receive subventions and have some of their taxes applied to the republican budget are Sugd Oblast, Dushanbe City and Tursunzade City. All other local units receive grants and retain 100 percent of local taxes provided for them within the Budget Law for that year. Jamoats obtain their financial resources in two ways: The first is from the raion budget, which draws from a local treasury account, while the second is from economic activities and voluntary contributions from enterprises or individuals which are earmarked for cultural, educational and other purposes. These funds are kept in a separate local account and are expended depending on the social and economic needs of the residents.

Accounting and Treasury Systems

130. At the local government level, Treasury accounting records for budget organizations are held in pro-forma manual systems. One of the local treasuries visited by the CFAA team used a very simple spreadsheet to consolidate the budget by functional and economic classifications. However, maintenance of these records is time-consuming and prone to error. Also, there was no evidence that the records are reconciled with those of budget organizations.

Reporting

131. Reports on local budget execution are prepared on a quarterly basis and are supposed to be disseminated to the public through local newspapers to increase transparency. However, no system exists for publishing annual performance reports that reflect the cost of services provided by local governments.

²³ The Budget Commission has no formal structure; nor is there any regulation or decree identifying its membership or functions.

132. With the planned computerization of the local treasury function, heads of finance departments at the oblast and district levels should be able to receive more detailed fiscal reporting on which to base decisions. Thus, local government needs must be considered when the new system is designed and introduced and local finance staff should be consulted to ensure they have input.

Internal Controls and Audits

133. Many local government transactions are settled in cash, which carries a greater risk of misappropriation. In the short-term, due to a lack of confidence in the local banking system, this is likely to continue. However, there are some simple controls, such as prominently posting information about the arrival of funds (for salaries) at the local government and strengthening control mechanisms that can help prevent fraud and misappropriation of funds.

134. The level of skills and quality of control work in local treasury offices is weaker than in the central Treasury. Thus, IAD staff from the central Treasury visit the oblasts to try and improve the quality of work and local staff are included in an annual training seminar held in Dushanbe.

External Oversight

135. Local budgets are prepared by local khukumats and approved in sessions of the local majlisies. The SFCC has offices in each oblast and conducts control activities bi-annually, according to law. In order to increase public participation and transparency, local governments may consider forming Budget and Audit Committees that include representatives of civil society and ensure that budget execution reports are publicly available on a timely basis after the year's end.

Recommendations

136. The new local government law is an important initiative and will need high-level support to ensure that local institutions have both the mandate and capacity to provide local services.

137. The donor community needs to work with central and local government institutions and help them understand the benefits of greater decentralization of services. Although this will be a challenging process, it is key to building local government institutions. The CFAA therefore concludes that a dual approach to capacity-building is essential: Central and local government officials need to be trained, and at the same time, community leaders and implementing agencies need encouragement to exchange experiences and coordinate efforts.

138. The CFAA recommends that the Government take steps on a pilot basis to develop capacity at the local level--both of elected council members as well as executives working in local government institutions. This will require the full commitment of senior Government officials to decentralized models of public service delivery.

139. The CFAA proposes the pilot program cover a range of reforms to improve local government financial management, including: (1) simplifying public sector accounting laws

and regulations to make them more comprehensible, (2) preparing annual performance reports which would be made available to the public, (3) developing an institutionalized financial management training program for local government staff and (4) forming both budget and audit committees.

VIII. ACCOUNTING AND AUDITING IN THE PRIVATE SECTOR

Background

140. By the standards of other transition countries in the region, progress is slow in the area of accounting and audit reform. Geographic isolation and the lack of any substantive capital market activity means that Tajikistan has had little exposure to modern international concepts of financial management. Demand for international standards of accounting and auditing have been restricted to banks with foreign ownership and donor-financed projects. At present, no international audit firms and only a small number of local audit firms have opened offices. Audits that are carried out according to international standards are conducted by firms based outside Tajikistan. Thus, costs are high and there is little evidence of significant knowledge transfer. While there are signs of change, much more needs to be done to bring modern methods of financial management to local enterprises. Because of particular fiduciary concerns regarding the banking sector, these are discussed separately in Section IX.

Financial Reporting for Enterprises

141. The requirements of the Tajik Accounting System (TAS) are laid out in the 1999 Law of Accounting. The Law, which applies to both the private and public sector, is based on rules rather than principles and is driven by bookkeeping and tax reporting requirements. The system's inadequacies are recognized by the Government, which, with assistance from USAID, is introducing a program to develop national accounting standards that conform with International Accounting Standards (IAS).²⁴ A working group²⁵ led by the Department of Accounting Methodology in the MoF was formed in February 2003.

142. A Presidential Decree²⁶ acknowledges the need for a gradual introduction of new financial reporting standards. Given the severe capacity weaknesses (highlighted below), the CFAA supports this approach. A number of recommendations are included.

Auditing

143. For the reasons mentioned above, development of the auditing profession is at an early stage. By a 2001 Order of the MoF,²⁷ insurance companies, investment institutions, joint stock companies, extra-budgetary funds, charities and joint venture companies must all be audited annually. All organizations listed in the Order must submit audited financial statements to the tax authorities and statistical agencies. However, it is unclear how the Government intends to enforce compliance, given the low capacity of the accounting and auditing profession.

²⁴International Accounting Standards (IAS) are set by the International Accounting Standards Council (IASC). The IASC is an independent international body, financed from private funds, with headquarters in London.

²⁵ The working group includes members of the Association of Auditors and Accountants of Tajikistan, the Public Institute of Professional Accountants and Auditors, the Ministry of Tax and Revenues, National Bank of Tajikistan and practicing accountants and auditors.

²⁶ Decree on International Financial Reporting Standards No. 428 (November 4, 2002)

²⁷ No13 dated January 29, 2001.

144. The 1999 Law defines the licensing and certification procedures for auditors. To help incorporate them, the Government created a qualifying commission for auditors which includes representatives from the MoF, Ministry of Justice, universities and the Ministry of Tax and Revenues. Candidates, who must take a three-hour exam, must have a degree and a minimum of five years practical experience as accountants, economists, financiers or lawyers. Applications cost 400 somoni and auditors who pass the examination are certified for five years. According to the MoF, certified auditors are required to take 20 hours of continuing professional education each year in MoF training courses conducted by the State University of Commerce.

145. The Law also provides for ensuring auditor independence, as well as the rights of auditors and clients. In addition, the MoF issued six audit standards which appear to have been influenced by, but do not completely correspond to International Standards of Auditing²⁸ (ISA). The MoF recognizes that current regulations for auditors need to be upgraded and it plans to prepare standards which correspond to ISA.

The Profession

146. Approximately only 50 professionals hold audit certificates and licenses issued by the MoF. As yet, few audit firms exist, although more local firms are seeking licenses due to the new mandatory audit requirements. Thus, the challenge of developing an audit profession that meets international standards remains daunting.

147. The Audit Law provides for a Chamber of Auditors to coordinate audit activities and promote the development of audit activities; however, to date, the Chamber has not been licensed and no activities have been conducted.

148. Two accounting institutes currently operate: the Association of Accountants and Auditors of Tajikistan and Public Institute of Professional Accountants and Auditors. Both have roots in academic institutions and their role has focused on training activities. Senior members in both institutes are collaborating with the MoF on the Accounting Standards Working Party mentioned above.

149. A USAID project is supporting the development of professional accounting and audit institutions by helping devise charters and by-laws that reflect international standards in governance and professional requirements.

Capacity Building

150. The supply of accountants, auditors and financial managers with an understanding of international auditing standards is still extremely low. Thus, continued effort will be needed to create a larger pool of financially literate professionals. With donor support, some attempts have already begun to improve the level of skills. For example, in 2001, USAID introduced a Certified International Professional Accountant (CIPA) training, education and certification program. Given in Russian, it has been conducted in several of the FSU countries. The course

²⁸ International Standards of Auditing are promulgated by the International Federation of Accountants.

and examination system are transparent and the technician level qualification seems appropriate to the current needs of Tajikistan accountants and financial managers.

Recommendations

151. **Financial reporting.** **The CFAA recommends** that the IAS financial reporting, particularly for high profile and public interest entities, be introduced in phases.

152. Based on experience in other developing countries **the CFAA recommends that:** (1) full IAS compliance should be required for public interest companies such as banks, insurance firms, other financial institutions/intermediaries and significant public and private commercial entities; (2) full IAS financial statements should be prepared by all entities, but the requirement (as is practiced internationally) should be relaxed for small and medium-size enterprises (SMEs). This should be based on forthcoming guidance issued by the IASC as part of a harmonized approach to SME reporting; (3) a structured and adequately resourced arrangement should be established to ensure the full and timely translation of the unabridged IAS, along with any implementation guidance that takes account of the Tajik context. The arrangements for translating the standards, which should be consistent, accountable and transparent, should focus on common solutions to common problems and involve representatives of audit firms and enterprises; and (4) the technical capacity of the Department of Accounting Methodology and the National Bank of Tajikistan should be strengthened, especially with respect to its practical understanding of IAS.

153. **Auditing.** **The CFAA recommends that** the 2001 MoF Order with respect to mandatory audits should be clarified and phased in gradually, in keeping with the technical (auditing) capacity available. This recommendation gives top priority to improving the quality of ISA audits of IAS financial statements for a small group of large enterprises, financial institutions and other public interest entities.

154. Strong enforcement is the key to improving the quality of financial reporting and auditing. Thus, **the CFAA recommends** the Government review the institutional arrangements for overseeing the accounting profession and licensing auditors.

155. Professional exams and training arrangements for bank and enterprise auditors need to be upgraded. These should correspond to IFAC education guidelines. **The CFAA recommends** the Government review the institutional arrangements for the training and continuing education of auditors and accountants.

IX. BANKING ARRANGEMENTS IN TAJIKISTAN – FIDUCIARY ISSUES

156. This section evaluates the fiduciary risks associated with the role of the central bank and commercial banks. The National Bank of Tajikistan (NBT) has a key role in World Bank-financed projects because, under the credit arrangements for Structural Adjustment Credits (SACs), borrowers must open and maintain a separate Deposit Account²⁹ in their central banks. Loan proceeds must be used for eligible purposes as defined in the Credit Agreement.³⁰

157. The NBT also supervises commercial banks, several of which have Special Accounts that hold revolving funds for World Bank investment projects. Thus, from a fiduciary perspective, the World Bank is concerned with the governance and financial management in these banks as well as the quality and transparency of the NBT's supervision.

Overview

158. As of October 1, 2003 the banking sector, governed by the Law on the National Bank of the Republic of Tajikistan and the Law on Banks and Banking Activities, consists of the NBT and 13 commercial banks, 1 foreign bank and 4 credit associations.³¹ It is highly concentrated, with the four largest banks – Agroinvestbank (AIB), Orientbank, Tajiksoderotbank (TVOB) and Amonatbank – controlling about 86 percent of assets and 87 percent of total deposits.

National Bank of Tajikistan

159. The NBT is independent, accountable to Parliament and responsible for supervising all commercial banks. It prepares financial statements according to International Accounting Standards (IAS) and has them audited according to International Standards of Auditing (ISA). The audit for the year ending April 30, 2002 was performed by the Amsterdam office of Pricewaterhouse Coopers. The financial statements are not published.

160. In its recent Article IV Consultation,³² the IMF noted that the NBT needs to improve its operational and policy performance so as to achieve macroeconomic stability. The Report also noted a number of serious accounting and administration issues in 2002, including (1) the payment of dividends at the same time that the Bank had a negative net worth, (2) the financing of non-core expenditures and (3) the absence of a centralized record of guarantees, pledges and other central bank contingencies. The IMF thus required an interim external audit of the 2002 financial statements. In addition, the IMF observed that, “While both reports³³ recommended remedial measures, the staff recommended the NBT to formulate a comprehensive restructuring strategy that will enhance the implementation of monetary policy

²⁹ See Bank Operational Directive 8.60.

³⁰ Typically, if loan proceeds are used to finance items imported from a non-member country or goods and services from the standard negative list.

³¹ This section of the report draws extensively from the IMF Country Report no. 03/5 2003 Tajikistan Selected Issues Paper (January 2003).

³² IMF Country Report No 03/10 – January 2003.

³³ IMF Safeguards Assessment 2001 and the PwC Audit for 2002.

and strengthen operational efficiency. Key measures that need to be included are better coordination and timing of policy actions, improved coordination of intervention in foreign exchange and domestic liquidity markets, improved accounting procedures, a reduction in staff and facilities, and the elimination of non-core activities.”

161. NBT now keeps accounting records for bank guarantees, directed credits and pledges. The most recent Staff Report of the IMF notes that the NBT is conducting a restructuring process to improve its institutional integrity and the implementation of monetary policy. This restructuring plan was agreed with the IMF³⁴.

162. The CFAA notes the recent progress to resolve some of the accounting and administrative issues in NBT. However, given the serious nature of the issues described, **the CFAA recommends** that when future adjustment operations are prepared, the Government and World Bank need to agree on detailed fiduciary arrangements. To avoid the commingling of Bank funds with other foreign exchange held by the NBT **the CFAA recommends** that funds are disbursed into a ring-fenced bank account in the name of the NBT at a correspondent bank acceptable to the World Bank. As with the current arrangements, the MoF will continue to have a separate account with NBT, until it sells the foreign exchange to the NBT and is in receipt of counterpart local currency in return. The negative list restrictions apply to the NBT account at the correspondent bank. **The CFAA also recommends** that the Bank should receive copies of the NBT’s annual audited financial statements together with the management letters from its auditor.

Prudential Requirements and Risks in the Banking Sector

163. The NBT has progressively raised the minimum capital requirements, and progress in the consolidation of commercial banks has been slow but satisfactory. As of October 1, 2003 eight banks met the minimum capital requirements; with six banks complying with all prudential standards.

164. All banks are required to implement IAS; however, due to financial and capacity constraints, this has not been fully realized in daily operations.³⁵ Further domestic audit firms, as noted elsewhere in the Report, do not have the capacity to conduct ISA audits; audits performed by international firms places substantial financial burden on the banking sector. Compliance with IAS remains a serious long term problem which needs to be addressed by further training both of accountants and the Tajik auditing profession.

165. A recent IMF report concluded that, “As indicated by the lack of compliance with prudential regulations and international accounting standards, the banking system is weak and vulnerable. Amongst the problems facing banks is credit risk, stemming from weak

³⁴ According to the NBT the restructuring strategy was completed after the draft CFAA was submitted to the Government.

³⁵ Common non-compliance in the banks’ financial reports includes inadequate provisioning and cash accounting of revenues.

information on borrowers and inadequate credit risk management, as well as sizeable non-performing loans.”

166. To strengthen the banks, the NBT will increase the minimum capital requirement from \$1.5 million to US\$2 million by the end of 2004. NBT has intimated that the practice of granting waivers to banks will be discontinued. Authorities will close or merge all banks that do not comply with prudential requirements and/or are not subject to a restructuring agreement with the NBT.

167 The CFAA Mission did not review banks with Special Accounts (for managing investment projects). However, given the fragile state of the commercial banks, the World Bank and NBT need to exercise particular care in the maintenance, exposure and operations of these Accounts. Thus, **the CFAA recommends** that the Loan Department in the World Bank should closely oversee the number and authorized allocations of Special Accounts and avoid concentrating funds in a single bank³⁶.

³⁶ During the 2004 Country Portfolio Performance Review (CPPR) it was agreed that the World Bank would conduct a review, to be completed by June 2004 to ensure that commercial banks holding Special Accounts for IDA-funded projects adhere to minimum standards acceptable to the Bank.

X. PORTFOLIO FIDUCIARY CONSIDERATIONS

Reliance on Public Sector Financial Management Framework

167. Given the previous analysis, public financial accountability needs to be substantially strengthened. Because of systemic weaknesses, it would be inappropriate to rely on the existing framework to satisfy the World Bank's fiduciary financial management requirements. Rather, during the project cycle, the Bank and senior Tajik counterparts need to acknowledge the inherent problems and build appropriate safeguards to minimize risks.

Project Financial Management

168. This section of the CFAA does not constitute a detailed assessment of the financial management arrangements affecting World Bank-financed projects. Also, the CFAA does not seek to confirm the appropriateness of the projects' financial management arrangements; it is not a substitute for regular project supervision. Rather, the CFAA identifies and addresses certain generic financial management issues in the portfolio.

Issues in the Country Portfolio Performance Review

169. The Country Portfolio Performance Review (CPPR) was held in Dushanbe in February 2002 with representatives of the Bank, Government and project implementing agencies. The following issues that bear on the financial management of Bank-financed projects were noted:

- **Government counterpart funding.** As in previous years, the 2002 State Budget allocated funds to cover the Government's contribution to projects financed by the Bank and other development organizations. However, due to cash flow problems described earlier, there have been delays in counterpart funds which slowed project implementation and can contribute to misuse of funds. The CFAA Team understand that delays and shortfalls in counterpart funding have decreased since the draft CFAA was submitted to the Government in June 2003.
- **Taxes.** The 2002 CPPR had discovered that there were occasions of inappropriate use of the Bank's funds to finance taxes which are ineligible expenditures. During the 2004 CPPR, this was not identified as an issue in the World Bank financed projects.
- **Transparency and openness in project implementation.** The CPPR discussed a number of specific measures which could be taken by Project Implementing Units (PIUs) to ensure greater openness and transparency of project activities. The ACU would have a key role to ensure that (1) tenders are conducted transparently, (2) bid prices are announced at a public meeting, (3) tender awards are announced to the public, (4) all project financial reports and audits are available to the public, (5) all PIU staff are selected in an open and competitive manner according to defined selection procedures, and (6) PIU and Government staff are strictly prohibited from accepting gratuities or remuneration (either monetary or in-kind) from contractors or other suppliers.

- **Project audits.** As noted earlier, capacity is lacking among local auditors. As a result, audit firms from outside Tajikistan are conducting project audits, which has translated into high costs and (frequently) low quality. The CPPR agreed that the 2002 audits should be a block tender, which should lower such costs through economies of scale.
- **PIU staff and salaries.** Frequent and non-transparent changes in PIU staff have contributed to implementation problems. Also, significant salary differentials between PIU and Government staff can cause delays in project implementation.

Project Financial Management Staff

170. Project financial management staff (at the PIUs) consist of one or two local staff and consultants who are employed at pay levels that differ significantly from Government civil servants and among projects; staff are paid mainly from credit and grant funds with co-financing by the Government. Responding to the CPPR, the Government passed a decree³⁷ on March 31, 2003 that set maximum salary levels for the staff implementing investment projects. However, many project personnel fear that salaries for new and existing qualified staff will be reduced to levels that would cause them to seek higher paying jobs in the private sector—a problem shared by other countries in the region. The effect of the decree needs to be monitored closely over time.

Project Financial Management Systems

171. Project implementing agencies are free to develop their own financial management systems. As there has been no guidance or oversight regarding the type of systems purchased, many have been adopted, ranging from simple spreadsheets, to standard accounting packages and fully customized project accounting software. Until recently, the most widely used package was TALLY, designed by an Indian company. However, it does not have the Russian language within its operating system. Thus, in 2002, many projects introduced the 1C Bookkeeping System, a simple Russian accounting software package. The price for a fully-implemented accounting software tailored to a particular project that is able to produce appropriate financial monitoring reports, deliver on-site training, develop relevant financial management manuals, and offer post-implementation support is US\$9,000-US\$30,000. The fact that there are such diverse systems among projects has resulted in a high level of financial management-related costs for software and consultants. Further, little, if any, integration exists with the line ministries and their financial management systems. Thus, **the CFAA recommends** that the Government establish a forum to oversee the development of project financial management systems, drawing on PIU staff experience.

Audit Arrangements

172. Based on the Bank's current audit policy and weighing alternative approaches, **the CFAA recommends** maintaining the current audit arrangements of Bank-assisted projects which require that annual audits be conducted by private sector firms. To reduce costs, the

³⁷ Decree of the Government of the Republic of Tajikistan # 119 as of March 31, 2003.

CFAA supports the single audit approach which should result in significant savings to the Government.

173. As noted above, a key consumer of international audit services in Tajikistan is the donor community. **The CFAA also recommends** that the Bank, other donor groups and the ACU review the financial management and audit arrangements in investment projects to explore what more can be done to reduce costs, improve quality and address the very limited capacity of local auditors.

174. The SFCC routinely performs compliance audits of externally-funded projects. **The CFAA recommends** that the Bank review them and consider their findings when preparing and supervising projects. Also, although SFCC reports offer important information for monitoring and evaluating portfolios, they are not submitted to Bank staff. Thus, **the CFAA recommends** that the reports routinely be sent to Bank staff as well as project auditors, as part of normal audit procedures used to supervise Bank projects.

ANNEX 1 - DEVELOPMENT ACTION PLAN

No.	Recommendation	Policy changes	Institutional Changes	Human Resource/capacity Requirements	Responsible Party	Priority Short/Medium/ Long Term
PUBLIC SECTOR BUDGET MANAGEMENT						
1	Develop the role and responsibilities of the Budget Committee formed by the Government in October 2003.	N/A	Creation of Budget Committee – Decree passed October 2003	Training and Support in developing the functions of the Committee.	Government, Ministry of Finance	For formation of 2004 Budget – by December 31, 2003.
2	Extend Treasury system computerization to the local treasury network.	N/A	N/A	Technical assistance in preparation of feasibility study and technical specifications.	Ministry of Finance	Linked to 7 (below).
3	Treasury should develop procedures to completely record commitments (including wages) through the automated expenditure controls already embedded in the system.	N/A	N/A	Procedures have been drafted with support of IMF.	Ministry of Finance	Development and implementation – short term procedures.
4	Cash Management Unit should be set up in MoF.	N/A	Creation of cash management unit	Technical Assistance to set up unit.	Ministry of Finance	Medium term
5	The recording and monitoring of debt, guarantees and state-enterprise debt need to be improved; capacity needs to be built to improve debt monitoring, analysis and the debt reporting systems in MoF.	N/A	N/A	Ongoing Technical Assistance	Ministry of Finance	Short/Medium term

PUBLIC SECTOR ACCOUNTING AND FINANCIAL REPORTING						
6	Working group of experts should review the long-term requirements of the Government's financial management system including accounting reforms to integrate accounting in treasury and budgetary institutions.	N/A	N/A	Support of international experts.	President's office, MoF	Medium Term by December 31, 2004.
7	A working group should evaluate the process of preparing and attesting to the 2003 Report.	N/A	N/A	Working group to include international experts.	President's office, SFCC, MoF.	Short term – by February 2004.
8	Multi-user training should be provided on financial management information for decision making. Such training should be given to various groups, including civil servants and legislators.	N/A	N/A	Technical Assistance	President's Office	Medium term – prior to 7 above.
INTERNAL CONTROLS AND INTERNAL AUDITING						
9	Arrangements for organizing the Treasury IAD should be revised according to the Treasury Manual.	N/A	Restructure arrangements within Treasury IAD.	N/A	Treasury	Short term
10	Strategy for the development of public sector internal audits should cover (a) staffing and skill requirements, (b) audit approaches and methodology and (c) structural/institutional arrangements.	N/A	N/A	Technical assistance	President's office/ MoF	Medium Term

EXTERNAL OVERSIGHT OF PUBLIC FINANCIAL MANAGEMENT						
		N/A	N/A	Technical assistance possibly through twinning with SAI.	SFCC/MN	Medium Term
11	A capacity development program for the SFCC should be prepared. The program should include an analysis and recommendations towards improving SFCC's accountability to the Parliament.	N/A	N/A	N/A	SFCC/WB	Attendance on course run by WB for project staff.
12	SFCC staff should be trained in the WB project-specific operational policies and procedures (including financial management, disbursement and procurement).	N/A	N/A	N/A	SFCC	Medium/long term – linked to 11 above.
13	The work of the SFCC should be reviewed on a regular basis by another SAI.	N/A	N/A	N/A		
STATE OWNED ENTERPRISES						
14	All SOEs should be constituted as joint stock companies with boards of directors with clearly defined roles and responsibilities.	Policy changes to structure of SOEs.	N/A	N/A	President's Office/State Property Committee/MoF/Line ministries.	Medium Term – aligned to 19 below.
15	Barki Tajik, Tajik Air, Tajik Telecom, Tajik Rail and Tajik Gas should prepare IAS/IFRS financial statements for an independent annual audit by an audit firm acceptable to the World Bank, carried out according to ISA. These statements should be publicly available.	In accordance with SAC 2 policy matrix.	N/A	N/A	President's Office	Tadaz (from 2001), Barki Tajik, Tajik Air (from 2003), Tajik Telekom, Tajik Rail, Tajik Gas (from 2004).

16	Government should create a unit to oversee governance arrangements, monitor quarterly financial flows, debt and arrears.	N/A	Create SOE monitoring unit.	N/A	President's Office	Medium Term
LOCAL GOVERNMENT AND COMMUNITY LEVEL INSTITUTIONS						
17	A project should be developed to improve local government financial management that should include: (a) simplifying public sector accounting laws and regulations; (b) preparing annual performance reports which would be made publicly available; (c) developing an institutionalized financial management training program for local government staff; and (d) forming budget committees and audit committees.	Some changes to accounting laws and regulations (align to 7 above).	N/A	Technical assistance through donor community	President's Office, Oblast/City administration.	Medium Term
ACCOUNTING AND AUDITING FOR ENTERPRISES						
18	Requirements for full IAS compliance should focus on public interest companies which should include (but not be limited to) banks, insurance companies, other financial institutions/intermediaries and other significant public and private commercial entities.	Changes to the Law of JSC and Banking Law	N/A	Ongoing technical assistance	MoF/NBT/President's Office	Medium Term
19	A structured, accountable, transparent and adequately-resourced arrangement should be created to ensure the full and timely translation of IAS and the development of necessary implementation guidance, taking the Tajik context into account.	N/A	N/A	Ongoing technical assistance	MoF/Working Group on Financial Reporting	Medium Term
20	The 2001 Order of the Ministry of Finance regarding mandatory audit requirements should be clarified and any statutory audit requirements should be phased in, in line with the available audit capacity.	Repeal order and clarify in Law of Audit Activity.	N/A	Ongoing technical assistance	Government/MoF/President's Office	Medium Term

21	Government should review the institutional arrangements for overseeing the accounting profession and licensing auditors.	N/A	N/A	Ongoing technical assistance	President's Office/MoF	Medium Term
22	Government should review the institutional arrangements for the training and continuing education of auditors and accountants.	N/A	N/A	Ongoing technical assistance	President's Office/MoF	Medium Term
BANKING ARRANGEMENTS IN TAJIKISTAN – FIDUCIARY ISSUES						
23	World Bank Loan Department and Government should oversee the number and authorized allocations of Special Accounts and avoid concentrating funds in a single bank.	N/A	N/A	N/A	World Bank/Aid Coordination Unit	Short term
PORTFOLIO FIDUCIARY CONSIDERATIONS						
24	Single audit approach should be adopted for World Bank projects.	N/A	N/A	N/A	President's Office/ACU	With effect from audits for year ended December 31, 2003.
25	SFCC audit reports on World Bank-assisted projects should be routinely sent to the Bank to help staff supervise Bank projects.	N/A	N/A	N/A	SFCC	Short term
DONOR HARMONIZATION OF FINANCIAL MANAGEMENT						
26	Standardize strategy for donor community financial management.	N/A	N/A	N/A	Donor community, President's Office, ACU.	By September 30, 2003.

ANNEX 2: EXECUTION OF REVENUES AND EXPENDITURES OF LOCAL BUDGETS IN 2002³⁸

Name of the budget	Actual revenues Som. (000)	Actual expenditures Som. (000)	Revenues of the local budget to state budget revenues (in %)	Expenditures of the local budget to state budget expenditures (in %)
State budget	544,392.0	524,400.0 ³⁹	---	---
Local budget, including	188,657.3	172,275.2	34.7	32.9
GBAO	10,764.2	10551.4	2.0	2.0
Khatlon oblast	48,176.8	46,507.7	8.8	8.9
Sogd oblast	45,795.1	45,805.2	8.4	8.7
Dushanbe city	53,239.9	39,999.2	9.8	7.6
Kofarnihon City	5,888.8	5,166.7	1.1	1.0
Rogun city	1,505.3	1,462.5	0.3	0.3
Tursunzade city	4,673.3	4,667.4	0.9	0.9
Varzob rayon	1,147.6	1,141.0	0.2	0.2
Garm rayon	4,074.4	3,900.3	0.7	0.7
Hissar rayon	1,865.8	1,854.2	0.3	0.4
Djirgital rayon	1,336.7	1,336.1	0.2	0.3
Darband rayon	1,146.3	1,146.3	0.2	0.2
Lenin rayon	3,878.1	3,882.8	0.7	0.7
Tavildara rayon	747.5	727.3	0.1	0.1
Tajikabad rayon	842.1	842.1	0.2	0.2
Faizabad rayon	1,892.2	1,637.8	0.3	0.3
Shahrinav rayon	1,683.2	1,647.2	0.3	0.3

³⁸ Source: Ministry of Finance.

³⁹ Final estimations.

MAP SECTION

