

## I. Introduction

### 1. Study Background

The 1997 financial crisis in Asia exposed structural weaknesses in the banking and corporate sectors of affected countries owing largely to poor governance, lack of transparency, and weak supervision and regulation.<sup>13</sup>

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (DMCs) in overcoming these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions in the DMCs. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

Regional Technical Assistance (RETA) No. 5877 – *Strengthening Financial Management and Governance in Selected DMCs* – was approved by ADB for the purpose of carrying out initial studies to identify gaps and weaknesses in financial management and governance, and to recommend courses of action to overcome these problems.

### 2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing accounting and auditing support and standards available in the selected DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. Objectives were to:

- (i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support to meet international standards and best practices, and address the issue of training and capacity enhancement

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<sup>13</sup> Zhuang, Juzhong, David Edwards, David Webb and Ma. Virginita Capulong. 2000. *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand*. Asian Development Bank: Manila.

- (ii) determine the existing accounting and auditing standards of each country
- (iii) assess the degree of deviation from International Accounting and Auditing Standards (IAAS) while identifying weaknesses and possible corrective options
- (iv) discuss the fieldwork findings and introduce the concepts of the international standards through workshops
- (v) develop reference materials for potential users of the IAAS, and
- (vi) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

### **3. Scope**

The RETA involved an in-depth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. Uzbekistan was one of seven countries that participated in the RETA.

### **4. Country Case Studies and Workshops**

The first part of the study examined the current accounting and auditing structure and systems adopted in Uzbekistan. It also: (i) analyzed the political, institutional, and regulatory and legal framework on accounting and auditing practice, and the level of enforcement of existing laws, rules, and regulations; (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards; and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

The second part of this study disseminated the findings of the country research through in-country workshops. Each workshop provided a cross-section of views on the findings of the research and established ways to move forward to improve financial management and governance in the country. After carrying out the assessment of accounting and auditing support in Uzbekistan, the study findings and recommendations were discussed at a workshop in Tashkent on 10-11 July 2000, and at an international conference at ADB headquarters in

Manila on 16-18 October 2000. This report incorporates feedback from the workshop and the conference.

## **5. The ADB Focus on Financial Governance in Uzbekistan**

An interim operational strategy has guided ADB's assistance to Uzbekistan since 1995, when it became a member. The strategy has focused on a small number of priority areas: (i) agriculture, including financial support of small and medium-size agro-industrial enterprises; (ii) infrastructure rehabilitation, especially in the road and railway sub-sectors; and (iii) education. In response to specific government requests, technical assistance activities have been conducted and programmed in the area of finance.<sup>14</sup>

## **6. Uzbekistan**

The democratic Republic of Uzbekistan was founded on 31 August 1991 following independence from the Soviet Union. The Republic of Uzbekistan comprises 13 regions and the autonomous Republic of Karakalpakstan. Uzbekistan and Liechtenstein are the world's only doubly landlocked countries. The country, which is situated in central and northwestern Asia, has a land area of 447,400 km<sup>2</sup>. It has borders with Kazakhstan, Kyrgyz Republic, Turkmenistan and Afghanistan.

The population of over 24 million is growing at around 1.3 percent per year. Major cities are Tashkent (over 2 million), Samarkhand (365,000), Namangan (362,000), and Andijan (320,000).

Uzbekistan's population comprises people from 100 different nationalities and ethnic groups. The largest groups are Uzbeks (75.8 percent), Russians (6 percent), and Tajiks (4.8 percent). The population is predominantly Muslim (88 percent) with an Eastern Orthodox minority (9 percent). The national language is Uzbek, spoken by 74 percent of the population. Native Russian (14 percent) speakers form a sizeable minority. Uzbekistan's assets include abundant natural resources and a well-educated population – 99 percent of the population is literate. Uzbekistan is the world's second largest cotton exporter, a major producer of gold and natural gas, and a regionally significant producer of chemicals and machinery. Major exports include cotton, gold, natural gas, mineral fertilizers, nonferrous metals, oil and oil products, textiles, food products, and automobiles. Major imports

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<sup>14</sup> Asian Development Bank. February 2000. *Country Operational Strategy: Uzbekistan*.

are machinery and parts, consumer durables, and other food. Uzbekistan's major trading partners are Russia, Ukraine, Eastern Europe, the United States, and Western Europe.

Following independence, the Government sought to prop up its Soviet-style command economy with subsidies and tight production and price controls. Faced with high rates of inflation, the Government began to reform in mid-1994 by introducing tighter monetary policies, expanding privatization, slightly reducing the State's role in the economy, and improving the environment for foreign investors. Uzbekistan initially responded to the negative external conditions generated by the Asian and Russian financial crises by tightening export and currency controls within its already largely closed economy.

Uzbekistan's GDP fell by about 20 percent during 1991-1995, but this economic contraction was not as severe as that of other Central Asian republics of the FSU. Moderate growth was resumed in 1996 averaging 4.8 percent annually in the two years that followed. Growth has since slowed and this is attributed to persisting needs for additional structural transformation, including large-scale privatization, agricultural liberalization and capital market development. Uzbekistan is one of only a few transition countries that operate a segmented foreign exchange market and two exchange rates<sup>15</sup>, in connection with strict controls of export and import markets.<sup>16</sup> The gradual liberalization of the foreign currency regime began on 1 July 2000 when limited currency convertibility was introduced. GDP growth of 4.4 percent in 1999 was maintained, but prices for primary exports continued to be weak. Structural reforms to sustain economic stability and growth, combined with policy measures to ease short-term social effects, are necessary.<sup>17</sup>

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<sup>15</sup> Among the countries of the Baltics, Russia, and other countries of the Former Soviet Union, only Belarus and Turkmenistan apply similar foreign exchange regimes to that of the Republic of Uzbekistan.

<sup>16</sup> Rosenberg, Christoph, and Maarten de Zeeuw. March 2000. *Welfare Effects of Uzbekistan's Foreign Exchange Regime*. International Monetary Fund Working Paper: WP/00/61.

<sup>17</sup> Asian Development Bank. 2000. *Asian Development Outlook 2000*. p. 82.