

Financial Management and Governance Issues in the Republic of Uzbekistan

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Prepared Under Regional Technical Assistance (RETA)
*5877: Strengthening Financial Management and Governance in
Selected Developing Member Countries.*

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Foreword

This report describes financial management and governance arrangements in Uzbekistan, identifies deficiencies in those arrangements, and presents recommendations to address those deficiencies. For the purposes of this study, financial management and governance arrangements are narrowly defined as being accounting and auditing arrangements and practices.

The report was prepared for the Asian Development Bank by Barry Reid (International Consultant) with overall guidance from Francis B. Narayan (Lead Financial Specialist, ADB) under Regional Technical Assistance (RETA) 5877 – *Strengthening Financial Management and Governance in Selected Developing Member Countries*. Nailya Ablieva and Dr Sobir Safaev provided excellent research assistance. The contents of the draft report were discussed and debated with representatives from the Government, the private sector, and international organizations at a workshop held in Tashkent on 10-11 July 2000. The issues and recommendations were further discussed at an international conference at ADB headquarters in Manila on 16 -18 October 2000.

This report should be read in conjunction with the Summary Report, which identifies and examines selected issues in relation to financial management and governance.¹

The authors would like to offer their appreciation to the numerous officials, researchers, and agencies that gave up their valuable time and made materials available during the course of the research. In particular, we would like to thank: V. Gnanathurai (Resident Representative) and the staff at ADB Uzbekistan Resident Mission for their support; Honorable Dr Djuraev Turobjon (Deputy Minister for Finance) and Professor Yuri Itkin (President, Association of Accountants and Auditors) for chairing the Tashkent workshop; Kunio Senga (Programs Manager, Programs Department West, ADB), for moderating the Manila conference session at which this report was discussed; and Shukurov Shukhrat (Chief of Banking and Finance Section, Cabinet of Ministers) and Honorable Dr Djuraev Turobjon, again, for their involvement in the study and their representation at the Manila conference.

¹ Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa P. Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Asian Development Bank.

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Currency Equivalents

(as at 31 October 2000)

Currency Unit – Sum

SUM 1.00 – \$0.00326

\$1.00 – SUM 307.25 (Official rate)

Note: On 1 July 2000, the Republic of Uzbekistan moved to partial currency convertibility. As at 9 July 2000, the market rate was around \$1.00 = SUM 782.50.

Abbreviations

AAA	Association of Accountants and Auditors
ADB	Asian Development Bank
CPA	Certified Public Accountant
DCEEA	Department for Coordination of External Economic Activities
DMC	Developing Member Country
EBRD	European Bank for Reconstruction and Development
EU-TACIS	European Union – Technical Assistance to the Commonwealth of Independent States
FSU	Former Soviet Union
GDP	Gross Domestic Product
HDCR	Head Department of Control and Revision
IAS	International Accounting Standard
IFAC	International Federation of Accountants
IMF	International Monetary Fund
MMS	Ministry of Macroeconomics and Statistics
MOF	Ministry of Finance
NAS	National Accounting Standard
PCR	Production Cost Regulation
PIP	Public Investment Program
RETA	Regional Technical Assistance
RUA	Republican Union of Auditors
SOE	State-owned Enterprise
TA	Technical Assistance
UNDP	United Nations Development Program

Notes

- (i) The financial year of all organizations, including the Government, ends on 31 December.
- (ii) In this report, \$ refers to US dollars.

Contents

EXECUTIVE SUMMARY	1
I. INTRODUCTION	11
1. Study Background.....	11
2. Objectives.....	11
3. Scope.....	12
4. Country Case Studies and Workshops.....	12
5. The ADB Focus on Financial Governance in Uzbekistan	13
6. Uzbekistan.....	13
II. ACCOUNTING AND AUDITING IN UZBEKISTAN	15
Part One. Accounting.....	16
1. Introduction.....	16
2. Issues and Responses since 1991.....	17
3. The ‘Uzbekistan Accounting System’.....	19
4. Financial Reporting Requirements.....	24
5. Bookkeepers and Accountants.....	24
Part Two. Auditing.....	26
6. Introduction.....	26
7. Governing Laws and Regulations.....	26
8. Audit Requirements.....	27
9. Auditor Licencing.....	27
10. Bank Auditing.....	28
11. Public Sector Auditing.....	29
12. Accounting and Auditing Firms.....	29
III. PROFESSIONAL INFRASTRUCTURE	31
1. Introduction.....	31
2. Association of Accountants and Auditors (AAA).....	32
3. Republican Union of Auditors (RUA)	35
IV. ACCOUNTING AND AUDITING STANDARDS	37
Part One. Accounting Standards.....	37
1. Introduction.....	37
2. Accounting Standard Setting Responsibilities	38
3. Uzbekistan Accounting Standards.....	38
4. Conformity with International Accounting Standards.....	39
5. Public Sector Accounting Standards.....	40
Part Two. Auditing Standards.....	40
6. Introduction.....	40
7. Development and Promulgation.....	40

V.	ACCOUNTING AND AUDITING TRAINING.....	41
1.	Introduction.....	41
2.	Educational Responsibilities and Coordination	42
3.	Higher Education.....	42
4.	USAID Accounting Training Initiatives.....	44
5.	British Council Accountancy Training of Trainers Project	45
6.	United Nations (UNDP) Accounting Reform Project	46
7.	Other Accounting Training Initiatives	47
VI.	GOVERNMENT BUDGETING AND ACCOUNTING.....	49
1.	Introduction.....	49
2.	Legal Framework for Budgeting and Reporting	50
3.	Budgeting Roles and Responsibilities	50
4.	Budget Composition.....	50
5.	The Budget Process.....	51
6.	Public Investment Programming Process.....	52
7.	Accounting Bases and Asset Management.....	52
8.	Financial Reporting.....	53
9.	Benchmarks, Ratios, and Covenants.....	54
10.	Accounting Information Systems.....	54
11.	Anti-Corruption Measures.....	54
VII.	DONOR ASSISTANCE.....	57
1.	Overview.....	57
2.	Coordination Mechanisms	58
3.	Asian Development Bank.....	58
4.	International Monetary Fund (IMF)	60
5.	The World Bank.....	61
6.	United Nations (UNDP)	61
7.	European Union (EU-TACIS)	62
8.	United States (USAID).....	62
9.	Japan (JICA)	63
10.	Turkey (TICA).....	63
11.	European Bank for Reconstruction and Development.....	63
12.	British Council Know-how Fund.....	64
VIII.	ISSUES AND RECOMMENDATIONS	65
	Part One. Where Donor Assistance Might be Appropriate	65
1.	Strengthening the Accounting and Auditing Profession.....	65
2.	Strategic Development Plan for Accounting Profession.....	67
3.	Establishment of Internal Auditing Profession.....	67

4.	Development of Accounting Standards.....	68
5.	Development of Auditing Standards.....	68
6.	Development of Educational and Training Materials.....	68
7.	Public Budgeting and Finance Issues.....	69
8.	Training for Accounting Lecturers and Professors.....	70
9.	Establish an Independent Supreme Audit Institution.....	70
	Part Two. Where External Assistance is Not Required.....	71
1.	AAA Membership Categories.....	71
2.	Independence of Auditing Firms from Government.....	72
3.	Independent Accounting Standard-Setting Body.....	72
4.	Regulatory Compliance Requirements.....	73
IX.	MAIN DEFICIENCIES AND ACTION PLAN.....	74
	REFERENCES.....	76

Appendixes

	Table of Appendixes.....	80
Appendix 1.	Interviewees.....	81
Appendix 2.	RETA-5877 (Regional Study) Information.....	83
Appendix 3.	Administrative and Institutional Arrangements.....	86
Appendix 4.	Regulatory and Legal Framework.....	89

Executive Summary

Background

The Republic of Uzbekistan was founded on 31 August 1991 following independence from the Soviet Union. Its capital is Tashkent. Following independence, the Government sought to prop up its Soviet-style command economy with subsidies and tight controls on production and prices. Faced with high rates of inflation, the Government began to reform in mid-1994 by introducing tighter monetary policies, expanding privatization, slightly reducing the role of the state 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.

While Uzbekistan's gross domestic product (GDP) fell by about 20 percent during 1991-1995, the economic contraction was not as severe as that of other Central Asian republics of the former Soviet Union (FSU). Uzbekistan resumed moderate growth 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. GDP growth of 4.4 percent in 1999 was maintained, although international prices for Uzbekistan's primary exports continued to be weak. Major structural reforms to sustain macroeconomic stability and growth are necessary, as well as policy measures to soften the short-term social effects of these reforms.²

Developments and Challenges

Accounting in the former Soviet Union (FSU), which included Uzbekistan, catered to the needs of statistical and tax authorities. It consisted of adhering to a prescribed chart of accounts that was designed to meet the requirements of the central planning system. The primary function of accounting was to record the factual data necessary to assess plan accomplishments, rather than to assess an enterprise's financial situation. The focus of Soviet accounting was more on bookkeeping than on the process of accounting. In fact, they were

² Asian Development Bank. 2000. *Asian Development Outlook 2000*. p. 82.

considered the same thing. Consequently, public accounting firms and an accountancy profession were never necessary. In fact, accountancy had a very poor reputation in the FSU. One study ranked accountancy at 91st place in terms of prestige on a list of 92 professional occupations.³

On independence from the Soviet Union in 1991, Uzbekistan took a gradual approach to market reforms. These reforms included making accounting and financial reporting practices and arrangements consistent with the needs of a market economy.

Objectives and Responses

In the decade since the beginning of the transition, Uzbekistan has made progress in terms of developing an accounting infrastructure suitable to the needs of a market economy. In 1992, a working group, led by the Ministry of Finance (MOF), was organized to draft new legislation. Work was conducted from January 1994 until December 1995 in which time the working group produced: a draft accounting law, including formats for financial statements; a production-cost regulation and associated materials; a revised chart of accounts; a draft auditing law; recommendations for a standard on foreign currency translation during periods of inflation; and preliminary recommendations for the strengthening of the accounting profession.

In contrast to other FSU countries, Uzbekistan realized that, for accounting reform to succeed, it would be necessary to separate financial accounting from tax accounting to prevent tax rules from distorting financial information. The *Production Cost Regulation (PCR)*, in simple terms, guided accountants in how to prepare income statements. The PCR was a key element in the Uzbekistan accounting reforms; this has been belatedly recognized by other FSU countries, which in the past couple of years, have begun to examine Uzbekistan's experiences in this respect.

Uzbekistan's first professional accountancy body, the Association of Accountants and Auditors (AAA) was established in 1992 and, in 1993, the UNDP/EU-TACIS-supported *Accounting Reform Project* began. One of this project's objectives was to provide accountancy and auditing training to over 100,000 'accountants.' The enactment of the *Accounting Law* in 1996 enshrined general accounting principles, the roles and responsibilities of entities, accounting practices, and financial reporting requirements,

³ Smirnova, Irina, Jaroslav Sokolov and Clive Emmanuel. 1995. Accounting Education in Russia Today, *The European Accounting Review* 4(4), 833-46.

in law. Notably, the *Accounting Law 1996* applies equally to public and private sector organizations. The first set of IAS-based National Accounting Standards (NASs) was promulgated in 1998. In 2000, the *Auditing Law* has tightened auditor-certification procedures and clarified the roles and responsibilities of auditors.

Accounting and Auditing in Uzbekistan

The 'Uzbekistan accounting system' is governed by the *Accounting Law 1996*, the provisions of which came into force on 1 January 1997. In 1999, the Cabinet of Ministers decreed that the Chart of Accounts should be updated so that it aligned with the new National Accounting Standards (NASs) that were based on International Accounting Standards (IASs).⁴ The new Chart of Accounts and Instructions were developed as a coordinated effort between the MOF and USAID consultants. They were approved, and were registered with the Ministry of Justice on 1 June 2000, as National Accounting Standard 21. Around 80 regulatory documents must be amended before the new Chart of Accounts comes into effect on 1 January 2002. In addition to the new Chart of Accounts and NASs, the MOF developed new forms of financial statements, initial documentation, order-journals, and books of register.

Asset management arrangements for public and private sector organizations are stipulated in the *Accounting Law 1996* and NAS 19. The basic financial reporting requirements, in accordance with the *Accounting Law 1996*, *Enterprise Law 1991*, and the *Taxation Code 1998*, are as follows: (i) accounting data must be prepared with guidance from NASs, and financial reports must be based on that accounting data; (ii) the annual financial reports of enterprises and organizations must be made available to banks, stock exchanges, investors, lenders, creditors, and others; and (iii) open companies,⁵ insurance organizations, banks, stock and commodity exchanges, investment funds, and other financial agencies, must publish their audited financial reports.

The MOF estimates that Uzbekistan currently has around 400,000 to 500,000 public and private sector 'accountants' of whom 148,000 are chief accountants (the *Accounting Law 1996* requires that every organization must have a chief accountant although chief accountants do not have to

⁴ Decree of the Cabinet of Ministers (No. 54). 5 February 1999.

⁵ Open companies are allowed to issue shares to the general public. Closed companies are not allowed to issue shares to the general public.

be certified accountants). These 'accountants' are equally divided between the public and the private sectors. This surprisingly high estimate is due to the: predominance of manual-transaction processing systems; the inclusion of bookkeepers, tax inspectors, and record keepers in the estimate; and significant compliance requirements imposed on organizations by regulations and statistical reporting requirements – Uzbekistan has an abundance of regulations and decrees, many of which are accompanied by the requirement to make reports to a range of government agencies.

Until 1991, auditing in the Soviet Union, which included Uzbekistan, reflected the highly prescriptive nature of the underlying accounting system. It was primarily a verification exercise, with the final accounts being compared to bookkeeping records by accountants from another enterprise within the same group. With the exception of a few large international firms, auditing in accordance with International Standards on Auditing (ISAs) is a relatively new concept in Uzbekistan. As such, qualified audit certificates have not been issued in Uzbekistan as National Auditing Standards (which are based upon ISAs) have only been recently introduced with the *Auditing Law 2000*.

Auditing licences are currently issued by the MOF to auditing companies, which must employ at least two certified auditors. The new *Auditing Law 2000* will tighten up auditor licencing. In particular, it states that audits can only be conducted by licenced audit firms (all audit firms must be registered with the Ministry of Justice); makes audit firms legally liable for the quality of their work and for the accuracy of their opinions; requires that an audit firm must employ at least two certified auditors; and requires that audit firms must meet and maintain minimum capital adequacy requirements. Article 21 of the *Auditing Law 2000* states that audit licences will be issued by the MOF which will also: design and approve norms regulating audit activities including national audit standards; control compliance of auditing organizations with their licensing agreement; set qualification requirements for candidates to be qualified as auditors; approve educational programs and the framework of examinations; conduct exams; revoke and terminate audit licences and publish information in the media about suspension or termination of audit licences; issue, suspend, and revoke qualification certificates; and maintain a register of qualified individuals and licenced organizations. The new process for issuing auditing licences was approved by the Cabinet of Ministers on

22 September 2000.⁶ The *Auditing Law 2000* also provided for the establishment of the *Republican Union of Auditors*, which is a nongovernmental, noncommercial organization that represents auditors on a voluntary basis. The Union's objectives are to assist in the development of, and to provide support to, professional auditors, and defend their professional interest. Its role will be to: participate in the design and approval of the curriculum and structure of the qualifying examinations, conduct the qualifying exams, and design and prepare proposals on improving audit legislation.

Uzbekistan does not have a Supreme Audit Institution (SAI). The Head Department of Control and Revision (HDCR), which is a division of the MOF, is the organization that is closest in concept to an SAI. The HDCR monitors financial activities, using a transaction-based approach (i.e., examination of financial transactions, identification of financial discrepancies, and fraud investigation). As a division of the Ministry of Finance, the HDCR would not appear to be independent from the Executive. However, the Government contends that the HDCR is independent as the Minister for Finance submits its reports directly to the Parliament.

Four of the five largest international accounting firms are represented in Uzbekistan. As of June 2000, there were 517 registered auditing companies in Uzbekistan. It is estimated that 108 of these auditing companies are subsidiaries of government agencies. The Government has recognized that these arrangements undermine auditor independence and the new *Auditing Law 2000* prohibits such linkages. In addition, 394 of these auditing companies have capital ranging from SUM200 to SUM100,000 (\$0.29–\$147.00). Many of these companies do not have offices and, in the opinion of some workshop attendees, do not even conduct audits. Moreover, in undertaking audits, many of these firms expose themselves to liabilities far in excess of their financial resources – i.e., they are not financially accountable for their audit conclusions (opinions). In recognition of this situation, the new *Auditing Law 2000* stipulates minimal capital requirements for auditing firms.

⁶ Resolution of the Cabinet of Ministers (No. 365). 22 September 2000. *On the Improvement of Audit Activity and Promotion of the Role of Audit Inspection*.

Professional Infrastructure

Uzbekistan's first professional accountancy organization, the Association of Accountants and Auditors (AAA), was formally established as a nongovernmental organization in March 1992 and currently has around 4,000 members. The AAA has two membership categories: associate member and full member. There are currently around 3,000 associate members and 1,000 full members. In general, associate members must have a bachelor degree and three years of practical experience, and must pass professional exams. Full memberships are granted once further professional exams are passed. Uzbekistan has sector-neutral accounting and auditing standards and a unified accounting profession. As such, officials do not consider it necessary to establish a separate membership category for public sector members.

The approval of the *Auditing Law* in May 2000, provided for the establishment of a state organization that would license auditors and audit firms (this responsibility was assigned to the MOF), and a *Republican Union of Auditors* (RUA) that would act as a professional body for auditors.

Accounting and Auditing Standards

One of the main aspects of accounting reform in Uzbekistan is the development of a series of National Accounting Standards (NASs) that are based upon IASs. Nineteen NASs were drafted towards the end of 1997 and by the end of 1998, 16 had been approved by the MOF and registered with the Ministry of Justice. The design and approval of NASs is the responsibility of the MOF. There are only minor differences between NASs and IASs, primarily due to accounting choices being restricted. Uzbekistan uses sector-neutral accounting standards. With very few exceptions, accounting standards and procedures apply to both the public sector and the private sector.

The *Auditing Law 2000* has only recently introduced the concept of auditing standards to Uzbekistan. Auditing standards are being developed based on International Standards on Auditing. As of June 2000, 10 out of the 24 National Auditing Standards that had been developed had been approved.

Education and Training

Like other states of the Former Soviet Union (FSU), Uzbekistan has a very high literacy rate (99 percent) and high educational standards. To maintain high education levels, and to improve the effectiveness of the education system in meeting the skills requirements and societal needs in a market economy, the Government is implementing an education system reform program. This program, called the *National Program for Personnel Training* was approved by Parliament in 1997. ADB is providing substantial support through project loans and technical assistance.⁷ It should be noted that, due to the lack of differences between public sector and private sector accounting practices, public sector and private sector accountants are trained under the same programs.

Twelve state institutions offer undergraduate and postgraduate programs in accountancy. The Accountants and Auditors Association (AAA) provides advice and input to universities and technical colleges in terms of the development and quality of accounting and auditing courses – their advice reflects input from private sector representatives. In addition, both USAID and the British Council have supported curriculum development. The accountancy curricula of tertiary institutions include courses on management accounting, financial accounting, international accounting, audit, finance, and taxation. Sector-specific and industry-specific courses are also offered, for instance, in transportation accounting. Four of the 12 educational institutions have been delegated auditor-training responsibilities. The Government's intention, as part of the overall accounting and auditing reforms, is to extend this right to nongovernmental organizations and other higher education institutions to broaden the regional provision of training.

Government Budgeting and Accounting

In line with other reforms, Uzbekistan has taken a gradual approach to reforming public sector budgeting, accounting, and reporting arrangements. These represent a continuation of pre-transition central

⁷ See for instance, Loan-1594: *Basic Education Textbook Development*, for \$20.0 million, approved on 17 December 1997.

planning systems. The Government is continuing to improve fiscal management systems and processes, particularly since 1996. In addition, a public investment planning (PIP) framework and process has been successfully established. The PIP framework covers capital budgeting and planning for the public sector.⁸ With respect to budgeting, the present *Law of Budget Principles* dates back to 1988. A new law on *Organization of the Budget of the Republic of Uzbekistan* was drafted in 1995, with USAID assistance, but was never approved. In 1999, in place of this proposed law, the Cabinet of Ministers approved a resolution on *Improved Order of Budget Financing*. This resolution updated revenue classifications to international standards, and adopted some of the more acceptable provisions that had been included within the proposed law.

Uzbekistan uses sector-neutral accounting. That is, with few exceptions, accounting standards, regulations, and procedures apply equally to public sector organizations and to private sector organizations. Budget organizations account and report in accordance with the *Accounting Law 1996*, NASs, Accounting Instructions for Budget Organizations and operational classifications of revenues and expenditures of the State Budget. The staged introduction of NASs, based on IASs, will improve public sector reporting because the accounting and financial reporting requirements for the private and public sectors are the same.

Donor Assistance

ADB has only recently commenced operations in Uzbekistan. The first Technical Assistance was approved on 9 July 1996 and the first loan on 17 December 1996. ADB has provided loans to support transport sector rehabilitation, textbook development, and rural enterprise development. Technical assistance has been provided along with these loans to support the development of financial management capacity within executing agencies.⁹ The major initiatives that ADB has supported, or is supporting, in direct relation to financial management and governance are as follows:

- TA on *Corporate Governance* (\$700,000: 2000–). The objective of this TA is to enhance transparency and disclosure in decision-making

⁸ TA No. 2771-UZB: *Improving Aid Coordination and Management*, for \$600,000 approved on 18 March 1997.

⁹ See, for instance, TA No. 2948-UZB: *Capacity Building in Education Finance*, for \$500,000, approved on 17 December 1997.

processes, and to strengthen the protection of investors' rights within enterprises in Uzbekistan.

- TAs No. 2771-UZB and 3190-UZB: *Improving Aid Coordination and Management* (\$600,000 and \$800,000). These TAs are supporting the development of a comprehensive and fully-integrated planning, budgeting and aid-management system, and a transparent procurement system.
- TA No. 3045-UZB: *Developing Commercial Banking Skills* (\$1 million). This TA supported the development of training capacity within the Banking and Finance Academy.
- TA No. 3352-UZB: *Strengthening the Banking Sector* (\$1 million). In addition to providing specific assistance to two commercial banks, this is supporting a comprehensive evaluation of the banking sector. The TA will also recommend measures to improve financial disclosure and corporate governance within the sector.
- Proposed Regional TA for an *Audit Training Program for Central Asian Republics*. The objective of this proposed TA, to Kazakhstan, the Kyrgyz Republic, and Uzbekistan, is to enhance government auditing capacity by introducing basic auditing concepts and techniques, and introducing basic fraud investigation techniques.

The **International Monetary Fund** program has been suspended since December 1996, due to the Government's introduction of restrictions on the trade and foreign exchange regimes. The **World Bank** has taken a lead role in the banking and finance sector, but has not provided direct assistance for upgrading accounting and auditing. The **UNDP / EU-TACIS** Accounting Reform Project initially had three directions: development of the *Accounting Law*, development of the *Production Cost Regulation*, and development of a new Auditing Law. In addition, a large training program was designed and implemented to support the introduction of the *Production Cost Regulation*. The project provided direct training to 1,800 accountants and tax inspectors. It was intended that these trainees would pass knowledge on to a further 100,000 'accountants'.

USAID has provided substantial support to improve accounting and auditing capacity and arrangements, including: (i) *Financial Sector*¹⁰ – USAID is providing support to improve bank supervision and the ability

¹⁰ 110-S001.4: *A More Competitive and Market Responsive Private Financial Sector*. \$1,500,000. Continuing since 1993.

of the Central Bank to enforce tightened financial performance and reporting requirements for commercial banks. In this respect, USAID has supported the training of accountants in commercial banks and assisted the Central Bank to develop reporting requirements for all commercial banks; (ii) *Fiscal Management*¹¹ – The purpose of this project is to improve fiscal policies and fiscal management practices. In early 1998, a new tax code and a proposed Budget System Law were introduced to Parliament but neither was passed by Parliament. USAID assistance has been responsible for three budget reform seminars and one seminar in fiscal reform; and (iii) *Accounting Reform*¹² – This project represents a continuation of the EU / UNDP efforts (see above) and was launched in late 1998. USAID advisors are working with the Ministry of Finance to introduce a new Chart of Accounts that is in accordance with IASs. Substantial training is also being provided to accountants. Since 1993, **JICA** (Japan) has organized training in Japan's financial and audit system for about 20 trainees from Uzbekistan. **TICA** (Turkey) has provided accounting training to 106 Uzbek financiers, and has supported the development of the Banking and Finance Academy through the training of teachers and students (1997–1998). The **European Bank for Reconstruction and Development** supported the foundation of the Banking and Finance Academy. The **British Council** has been providing ongoing support for accounting training. The project began in September 1992 with the objective to assist in the process of reforming accounting and accounting education. Under the project, over 300 teachers of accounting, finance, and management from accountancy education institutions throughout Uzbekistan have been intensively retrained in the new accounting requirements of a market economy. The approach taken has been to train accounting trainers. Nottingham Business School, the project consultant, has established Accountancy Training Resource Centers in leading accounting education institutions. Each resource center has well-equipped teaching rooms, a strong organizational structure, computer and reprographic facilities, and Internet and e-mail facilities.

¹¹ 110-S001.2: *Increased Soundness of Fiscal Policies and Fiscal Management Practices* \$800,000. 1993–2000.

¹² 110-S001.3: *Accelerated Development and Growth of Private Enterprises* \$6,200,000. 1998–.