May 2008
IMF Country Report No. 08/151

Kyrgyz Republic: Report on Observance of Standards and Codes— Fiscal Transparency Module

This Report on the Observance of Standards and Codes on Fiscal Transparency for the Kyrgyz Republic was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 30, 2008. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Kyrgyz Republic or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623-7430 ● Telefax: (202) 623-7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KYRGYZ REPUBLIC

Reassessment Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module

Prepared by the Fiscal Affairs Department

Approved by Mohsin Khan and Teresa Ter-Minassian

April 30, 2008

EXECUTIVE SUMMARY

This report provides a reassessment of fiscal transparency practices in Kyrgyz Republic in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (http://www.imf.org/external/np/fad/trans/manual/) should be consulted for further explanation of the terms and concepts discussed in this report.

Since the initial fiscal transparency ROSC published in 2002, Kyrgyz Republic has undertaken a series of actions leading to improved transparency of fiscal policy and fiscal management. The availability of fiscal information, including on public debt, to the public has strengthened. Most of the extrabudgetary funds and special means have been integrated into the budget. The integration of policy choices into the budget process has improved through the preparation of rolling three-year MTBFs. Budget presentation has improved with the introduction of a new budget classification based on the *Government Finance Statistics Manual (GSFM)* 2001. The 2004 Procurement Law provides a legal framework for procurement by government agencies in line with international best practice. The relations between the ministry of finance (MoF) and the National Bank of the Kyrgyz Republic (NBKR) have been clarified and there have been efforts to document the extent of quasi-fiscal activities (QFAs) in the energy sector. Resource revenue transparency has been enhanced through a commitment to implement the Extractive Industries Transparency Initiative (EITI).

At the same time, there are several areas where further progress in transparency is needed. The definition of government activities is complicated by the use of special means and the creation of a development fund. Transparency in intergovernmental fiscal relations has been affected by a lack of a consistent and stable legal framework. Fiscal reporting lacks comprehensive statements on medium- and long-term fiscal policy objectives, fiscal risks, QFAs, tax expenditures, and financial assets. Transparency in budget execution is undermined by the lack of a clear framework to introduce changes to the budget, differing accounting practices, and weak commitment controls. Internal control and internal audit practices are still not consistent with international standards. Policy with respect to the pay structure and terms and conditions for employment of government staff is fragmented. With regard to resource revenue transparency, the degree of discretionary authority held by the government in mining licensing is significant, and the process of tendering is not sufficiently transparent; legislation does not require full disclosure of resource-related revenue, loan receipts and liabilities, and asset holdings.

The following are some key recommendations to further improve fiscal transparency in the Kyrgyz Republic and help meet the standards of the fiscal transparency code: (1) clearly demarcate the boundaries between the general government sector and the broader public sector; (2) ensure a strong central role by the MoF in fiscal management and fiscal policy formulation; (3) develop a comprehensive framework for overseeing state-owned joint stock enterprises; (4) elaborate a consolidated legal framework to overcome the inconsistencies and fragmentation that has characterized intergovernmental fiscal relations; (5) adopt clear virement rules for reallocation of budgetary appropriations during the fiscal year; (6) improve budget documentation; (7) strengthen the expenditure control function by designing and implementing a comprehensive commitment control system through the treasury; (8) introduce an internal audit function in line with accepted international internal auditing standards; (9) adopt a comprehensive cash accounting system, incorporating an unified chart of accounts consistent with the budget classification; (10) expand the coverage of fiscal reporting; (11) prepare consolidated annual financial statements within six months of the close of fiscal year audited and certified by the chamber of accounts (COA); (12) introduce a harmonized framework for regulating the pay structure and terms and conditions of employment of government staff; (13) strengthen the external audit function; (14) further clarify the licensing procedures for exploration and development in the mining sector; (15) fully implement the EITI Initiative; and (16) consider a more systematic integration of resource revenue issues in budget preparation and reporting.

Contents Page

Acronyms 3

I. Introduction 4

II. Detailed Description of Practice 4
A. Clarity of Roles and Responsibilities...4
B. Open Budget Preparation, Execution, and Reporting 13
C. Public Availability of Information 23
D. Assurances of Integrity 26

III. IMF Staff Commentary...29

Boxes
1. General Government Budget in the Kyrgyz Republic, 2006 5
2: The Republican Budget Preparation Process...14
3. MTBF in Kyrgyz Republic 17
4. Budget Execution Accounting in the Kyrgyz Republic...22
5: Reconciliation Process in the Kyrgyz Republic 27
6. The Concept of Commitment Control 32
7. Kumtor Mine..38

Appendices
I. Resource Revenue Transparency..35
II. Summary of Key Findings from Past Fiscal Transparency Assessments 44

Appendix Tables
1. A Summary Assessment of Practices 46
2. Public Availability of Information—A Summary 54

ACRONYMS

CFPR	Centralized Fund for Poverty Reduction	
COA	Chamber of Accounts	www.ach.gov.kg
	Centerra (A mining company)	www.centerragold.com
EITI	Extractive Industries Transparency Initiative	
GFS	Government Finance Statistics	
GFSM	Government Finance Statistics Manual	
IPSAS	International Public Sector Accounting Standards	
KAFC	Kyrgyz Agricultural Finance Company	
MEDT	Ministry of Economic Development and Trade	
MoF	Ministry of Finance	www.minfin.kg
MTBF	Medium-term budget framework	
NBKR	National Bank of the Kyrgyz Republic	www.nbkr.kg
NSC	National Statistics Committee	http://www.stat.kg www.stat.kg/English/Sesituation/Default.html
PIP	Public investment program	
QFAs	Quasi-fiscal activities	
ROSC	Reports on the Observance of Standards and Codes	
SAGMR	State Agency for Geology and Mineral Resources	
SCC	State Customs Committee	
SCPP	State Committee on Public Procurement	www.goszakupki.gov.kg
SDDS	Special Data Dissemination Standards	
SPC	State Property Committee	
SSC	Savings and Settlement Company	
STC	State Tax Committee	www.sti.gov.kg
SWAP	Sector Wide Approach	
	Treasury	www.kazna.gov.kg

I. Introduction[1]

1. **This report provides a reassessment[2] of fiscal transparency practices in the Kyrgyz Republic against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*.** It has two parts. The first part is a description of practice, prepared by the Fund staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Kyrgyz Republic.

2. **The report also includes an assessment of practices against the *Guide on Resource Revenue Transparency*.** The assessment is presented in detail in Appendix I, while a summary of findings and associated recommendations are included in the IMF staff commentary (Section III).

II. Detailed Description of Practice

A. Clarity of Roles and Responsibilities

Definition of government activities

3. **General government in the Kyrgyz Republic is largely defined in line with government finance statistics (GFS) principles, and is mostly covered in the budget process.** *1.1.1*
Until 2006, there was a four-tier structure of government—republican (central), oblasts (province), rayons (regional), and municipalities—with each level of government having its own budget[3]. The authorities, however, introduced a two-tier (republican and local) system of budgeting in 2007. The central government budget consists of a current budget, a special means budget, and a development budget. The government also prepares a consolidated state budget that includes the central government and local governments. The

---

[1] Discussions on fiscal transparency were held in Bishkek during September 11–25, 2007. The IMF staff team comprised Mr. Villafuerte (Head), Mr. Pattanayak, Ms. Bordon (all FAD), and Mr. Eggert (member of FAD panel of experts). The mission met with a number of senior officials of the MoF, including Mr. Mambetjanov (Permanent Secretary), Mr. Temirbekov and Mr. Kojoshev (both Deputy Ministers), and Mr. Kyljiev (Budget Director). It also met with Mr. Chudinov, Minister of Energy, and officials from the central treasury and one official from the regional treasury, the ministry of health, the ministry of education, the NBKR, the ministry of economic development and trade, the SPC, the social fund, the STC, the SCC, the national statistics office, the department of fuel and mineral resources, the state agency for geology and mineral resources, the civil service agency, the COA, representatives of state-owned energy companies and Kyrgyzaltyn, the budget and finance department in parliament, representatives of civil society and business, and several donor agencies. Mr. McHugh provided substantial support to the mission through his office. The mission was also expertly assisted by Ms. Zarya and Ms. Engalytcheva (interpreters).

[2] The original fiscal transparency ROSC was published in March 2002 and a partial update was done as part of the 2004 Article IV Consultation Staff Report published in early 2005.

[3] The term “republican” used in this document refers to “central” and vice versa.

definition of government activity is consistent between the MoF and the central bank (NBKR). Some government activities, however, are still not covered in the budget. These include in-kind transactions[4] and operations of certain state agencies, such as the state fund for economic development.[5] It is also not clear whether the recently-created development fund should be treated as a general government unit or not.[6]

4. **The general government currently includes the central and local governments as well as the social and medical insurance funds, two extrabudgetary funds (Box 1).** *1.1.1*

The social fund has its own budget, which is also approved by parliament. The social fund is regulated by the *Law on the Social Fund of the Kyrgyz Republic* and the *Law on State Pension*. It receives transfers from the budget (social contributions in respect of

Box 1. General Government Budget in the Kyrgyz Republic, 2006

	In millions of Soms	**In percent of GDP**
General government in the Kyrgyz Republic comprises the following:		
1. Republican government units covered by the budget	22,404.3	19.8
Of which: Current budget 1/	15,434.9	13.6
Special means budget	2,051.8	1.8
Development budget	4,917.6	4.3
2. Republican government units with individual budgets	4,098.3	3.7
Social Fund 2/	3,915.4	3.5
Medical insurance fund (part not covered under republican budget and social fund budget)	182.9	0.2
3. Local government 3/	6,794.8	6.0
General government budget (1+2+3)	33,297.4	29.5

1/ Excluding grants and other interbudgetary transfers to local governments budget.
2/ Excluding payroll contributions from republican government budget and budgetary transfers.
3/ Excluding interbudgetary transfers republican government budget.

[4] For example, the ministry of water resources provides irrigation services to agricultural firms and these firms in turn make in-kind payments (agricultural products).

[5] This fund functions as a separate government body to maintain records and supporting documents in respect of loans extended by the government to various beneficiaries (e.g., credits provided to rural borrowers to support agricultural activities), as well as to monitor loan repayments. Seven percent of the total loan repayment amount accrues to the fund as its revenue, of which 30 percent is transferred to the budget. The fund's operations—including the salaries paid to its staff—are not on budget, but are processed through the treasury system.

[6] The development fund, with 100 percent state equity, was established in August 2007 under the *Law on the Development Fund.* The fund's tasks include the implementation of strategic projects, and it will receive transfers from the republican budget on a regular basis and submit reports on their use to the concerned republican budget execution agency. Although the fund is established in the form of a joint stock company (the sale proceeds of the government shares of Centerra Gold Inc. shall be transferred to the fund and constitute its statutory capital), its entire profits will be transferred to the republican budget (the *Law on Joint Stock Companies* requires the distribution of at least 25 percent of net profit as dividends).

government employees) and contributions of private employers. The medical insurance fund is established under the *Law on Medical Insurance* and is a separate legal entity within the ministry of health. Its funding sources are: (i) transfers from the budget (to administer the state guarantee benefit scheme); (ii) transfers from the social fund (to administer the mandatory health insurance scheme for the working population); (iii) donor grants; and (iv) the receipts of copayments made by the respective beneficiaries.

5. **The use of special means (user charges and fees) complicates the definition of boundaries of the general government sector and its consistent coverage in the budget process.** *1.1.1*

According to the *Regulation on Special Means and Deposited Amounts of Budget-Financed Institutions,*[7] special means are proceeds received by budget institutions themselves in addition to funds allocated to them through the budget (both current and development budgets). Special means could be generated by obtaining a permit and are defined as revenues of budget-financed institutions resulting from the sale of products, conducting of works, provision of services or other types of activities. Decisions on the use of special means are made by the managers of the respective budget-financed institutions. A separate annex to the annual budget (called Special Means Budget) shows the revenue and expenditure estimates for each category of special means. The treasury is allowed to open separate ledger accounts for deposit and use of special means revenues by budget institutions.[8] Expenditure under special means is financed by the special means revenues of the corresponding fiscal year as well as any unspent balance available at the close of the preceding year. Some of the activities funded through special means fall under the category of market-based activities.[9] However, the current regulations do not clearly distinguish between nonprofit/nonmarket institutions that should be included in the general government sector and nonprofit/market institutions and public corporations that should be included in the broader public sector. This complicates the definition of boundaries between the two for identifying the coverage of the general government in the budget process.[10]

6. **The relationships between government and public nonfinancial and financial corporations are not always clear.** *1.1.4*

---

[7] Decree No. 531 dated August 28, 2000 and subsequently revised in 2004 and 2005 (No. 375 dated August 18, 2005). A policy implementation unit of the MoF is currently working with a new draft of this regulation.

[8] According to the *Regulation on Special Means and Deposited Amounts of Budget-Financed Institutions*, each budget-financed institution having special means is allowed to open one special account with the treasury for all types of special means generated by it.

[9] For example, the National University under the ministry of education earns special means revenues by running a hotel and resort on a commercial basis, and the revenues of the Kyrgyz-Timur Railroad under the ministry of transport are treated as special means revenues in the budget.

[10] For more detail, see IMF, *Government Finance Statistics Manual,* 2001, p.10.

Public nonfinancial and financial corporations are guided by the same legal framework that applies to private corporations.[11] However, in practice some public corporations perform QFAs without an explicit statement of their related costs. In the banking sector, the state-owned commercial bank, Ayil Bank, lends at below-market interest rates to rural households and enterprises (see paragraph 13). In the energy sector, which is mostly owned by the government, electricity tariffs are set at below cost-recovery levels (see paragraph 8). These companies do not receive direct transfers from the government.

7. **The government is extensively involved in financial and nonfinancial sectors such as energy, mining, oil and gas, banking and telecommunications.** *1.1.4*
In the energy sector, the government owns more than 80 percent of the shares in each of the seven generation, transmission, and distribution companies. In the mining industry, the fully state-owned company, Kyrgyzaltyn, operates one gold mine and has equity ownership in several others. In the oil and gas sector, the government owns 85 percent of Kyrgyzneftegas. In banking, the government owns 100 percent equity in two commercial banks, Ayil Bank and the Savings and Settlement Company (SSC). In telecommunications, the government owns 90 percent of the fixed line communication monopoly, Kyrgyztelecom.[12] The government is planning to privatize some of these companies, particularly in the energy sector. While specific policy guidance is provided in some cases by the associated sectoral line ministries, the state property committee (SPC) is entrusted to oversee the management and privatization of state equity holdings. However, in practice there is no clear monitoring framework of state-owned enterprises or a comprehensive strategy to maximize the value of the government's equity holdings, apart from the design of privatization programs that have been only partially implemented. Although the SPC receives annual reports from state-owned joint-stock companies, it does not consolidate the information or submit a standard report to the government and/or parliament.

Government relations with nonfinancial public corporations and the private sector

8. **QFAs by state-owned electricity firms are substantial.** *1.1.4*
The government sets the tariffs of electricity firms at below cost-recovery levels. The quasi-fiscal deficit of the sector was estimated by the World Bank to range between 5 percent to 6 percent of GDP in 2006. As a result, electricity firms delay maintenance and investment spending and accumulate arrears among themselves and with the state tax committee (STC) and the social fund.[13] Tax authorities have attempted to seize the assets of electricity firms, but the government has issued decrees that prohibit this.[14] The

[11] *Law on Joint-Stock Companies* and *Law on Banks and Banking Activities.*

[12] The government owns 78 percent while the Social Fund owns 12 ½ percent. The remaining shares belong to private entities.

[13] Some of these arrears are due to nonpayment of electricity bills by budgetary institutions. In the past, government undertook offsets between electricity firms and the government budget. This practice has been discontinued since 2005.

[14] *Law on Special Status of the Toktogul Power Plant* and the annual decree, *Preparation of Autumn and Winter Season.*

complex array of distortions stemming from the tariff structure has made it difficult to hold managers of state-owned enterprises accountable, although this has not stopped the government, through the SPC, from recommending the firing of top executives. The extent of QFAs is not included in budget documentation. However, efforts have been made to make it transparent, and the size of this quasi-fiscal deficit, although not the potential fiscal implications, is presented in the medium-term budget framework (MTBF).

9. **Arrangements regulating profit transfers from state enterprises to the budget are clear.** *1.1.4*
The *Law on Joint Stock Companies* requires the distribution of at least 25 percent of net profit as dividends unless decided unanimously by shareholders. The exact profit transfer from state enterprises to the budget is approved by shareholders with the recommendation of the Board of Directors. In practice, state enterprises have transferred around 25 percent of their net profits.

10. **The legal framework for privatization is clear, and privatization processes and payments of receipts to the budget are broadly clear.** *1.2.5/4.2.4*
The *Law on the Privatization of Public-Owned Property* and the *Civil Code* provide the legal basis for privatization. In addition, the government formulates a privatization program, which it submits to parliament for approval. The government is in the last of its four-stage privatization program which involves the sale of large strategic firms that have been corporatized. In 2006, parliament approved the latest program, which contains the broad conditions, criteria, and timeframe of privatization as well as a list of entities to be privatized, with the caveat that the government is allowed to amend this list. The program also enables the government to introduce a "golden share" that gives it the right to veto decisions made by the general meeting of shareholders, when it deems necessary in order to protect state interest.[15] The SPC oversees the overall privatization process, while the program provides for the creation of specific sectoral commissions involving the relevant ministries and the SPC as members. Each commission decides on the exact terms of the process, including the privatization method. Privatization proceeds are reflected as financing in the budget. In practice, government has had difficulty abiding by the timeframe of the program due to some resistance to the sale of state-owned assets to foreigners and lack of interest from investors.

11. **Laws and processes governing government regulation of the nonfinancial private sector are not always clear and open.** *1.1.5*
Laws and regulations are often fraught with contradictions, giving regulators and government inspectors some discretion. Licensing and business registration procedures are long and cumbersome. According to the International Finance Corporation's Doing Business Index (2008), the Kyrgyz Republic is rated 94 out of 178 countries in the

[15] There have been no instances yet when golden shares were introduced as other legislation such as the *Law on Joint Stock Companies* and the *Civil Code* do not provide for them. Pending government approval, the SPC will be submitting amendments to these laws to parliament.

composite index of the ease of doing business.[16] The government has, however, taken steps to simplify the complex regulation system. The *Law on Inspection Procedure in Conducting Inspections of Businesses*, passed in June 2007, provides a legal framework for regulation of commercial entities by authorized bodies and limits the scope for discretion. The law outlines the rights of businesses, including an explicit provision that vagueness in legislation cannot be used against them. The anti-monopoly committee regulates corporations with large market shares, except for those that are in energy and communications and are directly handled by their respective sectoral ministries. A *Law on Competition* provides the legal basis for regulation of monopolistic activity.

Government relations with the central bank and public financial sector

12. **The NBKR is legally independent, and it has no fiscal role.** *1.1.4*
The NBKR is guided by the *Law on the National Bank of the Kyrgyz Republic* which clearly specifies the relationship between the government and the NBKR. The law prohibits the NBKR from making loans to the government and other state bodies. The Law also specifies that 70 percent of profit after deductions for required reserves be transferred to the government budget. Deposits of the government are remunerated at market interest rates. In turn, the NBKR charges the government a minimal fee for the services it provides, while its claims on the government are also linked to market interest rates.[17] The chairman and members of the management board are all appointed by the president for a term of seven years and only the chairman's appointment needs to be confirmed by parliament. Operationally, there has been stability in the tenure of the chairman. Turnover among members of the management Board has been higher. The COA is required by law to audit not only the NBKR's administrative expenditures, but also the monetary policy and international reserves. This has allowed parliament to scrutinize the NBKR's accounts and make proposals that could threaten its independence.[18]

13. **Public financial corporations do carry out some QFAs.** *1.1.4*
The government fully owns two commercial banks, Ayil Bank and the SSC. Ayil Bank, which accounts for 11 percent of total credit in the banking system, charges average loan interest rates of around 15 percent compared to 34 percent among microfinance institutions and 20 percent among commercial banks although it does not receive any direct subsidy from the budget. Previously named the Kyrgyz Agricultural Finance Company (KAFC), Ayil Bank was created in 1997 to increase credit in the rural sector. Despite the lower-than-market rate, the bank remains profitable and has a relatively low share of

[16] The Kyrgyz Republic is ranked 19 out of 28 Eastern Europe and Central Asian countries. Vis-à-vis all 178 countries, neighbors like Kazakhstan, Russia, and Uzbekistan are ranked 71, 106, and 138, respectively.

[17] The Joint Decree of the Government of the Kyrgyz Republic and the NBKR "On settlement of the financial relations between the Government of the Kyrgyz Republic and the National Bank of the Kyrgyz Republic" took effect on June 2002.

[18] Parliament has proposed to raise the profit transfer to the budget from 70 percent to 100 percent, to use international reserves to import fuel and wheat, and to gain power to appoint some seats of the management board.

nonperforming loans, owing to its funding from onlending by the government of concessional World Bank and ADB loans. The government envisions that two-thirds of Ayil Bank will be privatized by the end of the year. The SSC, previously owned and operated by the NBKR, is the bank with the most branches and undertakes the provision of payment services by and to the government, particularly the collection of utility payments and release of salaries and transfers.[19] It accounts for 3 percent of total credit in the banking system. SSC is profitable, earning most revenues from fees collected on these services to the central treasury and state-owned utility companies. No government unit quantifies the cost of or reports on these banks' QFAs. The NBKR supervises both banks, like any other commercial bank.

Fiscal management relations among the branches of government

14. **The fiscal roles of the executive, legislative, and judicial branches are defined in the constitution and relevant laws.** *1.1.2*
The powers of the president and the legislative, executive, and judicial branches are defined in Chapters 3, 4, 5 and 7 of the constitution, respectively.[20] Parliament has the prerogative of approving the republican budget. The fiscal powers and responsibilities of parliament and the executive branch are also set out in the *Law on Basic Principles of Budget*. Under Article 18 of this law, if the annual budget law is not approved by the start of the fiscal year, the government is authorized to undertake monthly expenditures within the limits of one-twelfth of the annual budget estimates for the corresponding fiscal year.

Fiscal management relations among different levels of government

15. **The responsibilities of different levels of government are not clearly defined and can vary from year to year**. *1.1.3*
Although various laws refer to a two-level budget (republican and local), none give a clear definition of a local government.[21] As a result, the oblast and rayon levels will change from being part of the republican budget (current 2007 two-tier budget) to having their own budget (planned 2008 three-tier budget—one republican and two-level local). Although the legal framework defining revenue responsibilities exists,[22] it does not provide adequate guidance on the determination of revenue shares, and its explicit

[19] The SSC operates a lending scheme to government employees, charging market-based interest rates.

[20] Subsequent to the fiscal ROSC mission in September 2007, a new constitution was approved in a nation-wide referendum held on October 21, 2007.

[21] The *constitution* defines local self-governance to be the right of administrative territorial units. It provides for the state budget, as composed of the national and local budgets. The *Law on Basic Principles of Budget* states that the local budget finances activities not just of organs of local self-government (*ayil okmotus* and villages), but also of local state administrations (oblasts and rayons).

[22] The *Law on Financial and Economic Basis of Local Self-Government* was signed by the president in September 2003. It was only effectively implemented in 2007, when a two-tier budget was introduced.

definition of the revenue base is occasionally superseded by the annual republican budget. Every year, the republican budget law specifies the revenue base and tax shares of different levels and types of local governments. The process of determining the base and shares within the MoF is not transparent and changes can occur each year, despite a provision in the law restricting revisions of shares to once every three years.[23] The expenditure assignments for lower levels of government have a legal basis,[24] although in practice, they are not always implemented.[25] Arrears in local governments exist, and this is recognized in the annual republican budget, which requires arrears from the previous year to be financed within the current year's budget, with priority to payroll and social fund contributions. Such arrears are not, however, formally monitored by the MoF. The law provides for three kinds of budgetary transfers: categorical, equalizing, and matching grants. Government instructions guide the determination of transfers.[26] In practice, grants could also be distributed via nontransparent offsets in the central level as in the case when the republican budget covers the local government's arrears in utility payments. Local governments are legally allowed to borrow, with the consent of the local parliament and the MoF, but the MoF has yet to formulate the criteria that will guide the decision to approve borrowing.[27] In practice, there has been no record of local government borrowing.

The legal and administrative framework for budget management

16. **The legal framework for management of public funds is generally clear, but risks fragmentation due to a division of fiscal management functions between two ministries.** *1.2.1*

The key principles for management of the republican and local budget processes are set forth in the *Law on Basic Principles of Budget,* the *Law on Financial and Economic Basis of Local Self-Government,* the *Law on the Principles of Treasury* and various government decrees. The annual budget law establishes fiscal targets and constraints.[28] The *Law on State Social Insurance* and the *Law on State Pensions* regulate the Social Fund. The MoF plays a dominant role in fiscal management, but its role is likely to change, and some of its

---

[23] For instance, the draft 2008 budget removes revenue sharing for profit taxes, which is defined as a shared tax in the law, and for the first time assigned 100 percent of patent taxes to local governments.

[24] The *Law on Local Self-Government and Local State Administrations* was signed into law in 2002.

[25] For instance, the budgets for pre-school and secondary education were assigned to cities and *ayil okmotus* but oblasts and rayons continue to finance these budgetary institutions.

[26] *Instruction on Formula on Calculation of Equalizing Grants* and *About Measures on Introducing the Mechanism of Stimulating (Matching) Grants*.

[27] Some legal restrictions exist. The *Law on Financial and Economic Basis of Local Self-government* prohibits borrowing when debt service will exceed to not more than 20 percent of annual revenues. Meanwhile, the *Basic Principles of Budget Law* restricts outstanding debt at 20 percent of annual revenues.

[28] Starting with the 2007 budget, fiscal targets for three forward years, such as total revenue, expenditure and deficit targets, are included in the annual budget law.

functions could overlap with that of the newly created ministry of economic development and trade (MEDT).

17. **Foreign-financed development expenditure is not well integrated with budgetary operations, which complicates monitoring and fiscal management.** *2.1.5*
As noted in Box 1, the social fund and the medical insurance fund are extrabudgetary funds, which are regulated through respective laws. General government expenditure financed from special means revenues are also approved by parliament in the budget. However, the public investment program (PIP) financed by donors is shown separately in the budget documents and is not fully covered by treasury operations. Information on projects financed by donors is incorporated in budget documents. The annual law on the budget determines the overall budget deficit target including information about projects to be financed by donors.

The legal and administrative framework for tax policy and administration

18. **The legislative basis for taxation is clear and is comprehensive but the scope for interpretation and discretion by tax officials is significant.** *1.2.2*
The tax and customs codes provide the legal basis for taxation and exemptions. The government has drafted a new tax code, which would integrate tax rules into a single code, simplify provisions, and remove inconsistencies. Within the existing code, the business tax for small business has been simplified, which should help reduce compliance costs, reduce incentives to avoid tax payments, and increase collection rates.

19. **Tax exemptions are large in number, and tax expenditures are not reported.** *1.2.1/3.1.3*
Nevertheless the number of exemptions is not inconsistent with tax rules of other countries. The state customs committee (SCC) and the STC estimate the value of foregone tax and customs revenues due to exemptions in their periodic reports to the MoF. These estimates are not made public.

20. **Tax administration is clearly defined and is mostly coordinated with overall fiscal management. The STC and the SCC now are independent entities with ministerial status.** *1.2.2/4.2.6*
The STC and the SCC generally are organized by function. The STC has a special unit to administer large taxpayers and should continue to enhance its capabilities. The STC has a department responsible for internal compliance with tax legislation and regulations. It also has a unit providing taxpayer services, which maintains a website and periodically places information for taxpayers in the mass media. Employees of the STC are subject to the code of conduct designed for all public servants and employees of the SCC are governed by the Law on Serving in Customs and the Customs Disciplinary Charter.

21. **Taxpayers' legal rights are largely defined.** *1.2.2/4.2.6*
The tax code contains a taxpayer bill of rights, used as the basis for 15–20 taxpayer appeals per month, as reported by the STC. However, the appeals procedure should be more fully described in the tax code. There are no separate tax tribunals. Appeals are

handled by the civil courts, and the process is lengthy, discouraging the use of the appeals process.

Public servants' code of behavior and anti-corruption activity

22. **Some initiatives have been taken to regulate the conduct of public servants.** *4.2.1*

The Kyrgyz Republic participates in the Istanbul Anti-Corruption Action Plan. It has established a national agency for the prevention of corruption,[29] which is responsible for the assessment of the effectiveness of anti-corruption measures undertaken by government authorities. However, in practice, comprehensive and effective anti-corruption measures have yet to be undertaken. A draft anti-corruption law is being prepared, which will cover all public servants and prescribe a code of ethics for them.

B. Open Budget Preparation, Execution, and Reporting

23. **The key stages of the annual budget process are legally specified and the rest of the budget calendar is regulated by an order of the MoF each year.** *2.1.1*
The main steps and timing for budget preparation are described in Box 2. The *Law on Basic Principles of Budget in the Kyrgyz Republic* prescribes the due dates for key stages of budget preparation. Additional dates are prescribed through an order of the MoF every year.[30] The fiscal year runs from January 1 to December 31, and the budget preparation begins when the MoF issues instructions to all line ministries/agencies setting the dates for different steps of the budget preparation process. After the finalization of the MTBF by the coordination council headed by the prime minister, the cabinet approves the sectoral expenditure ceilings which are then communicated to line ministries/agencies. The ministries and budget units in turn prepare their budget requests and submit them to the MoF by July. After negotiations between the ministries/budget units and the MoF and the approval of the draft budget by the cabinet, the budget is submitted to parliament for approval. However, there have been delays in having an approved budget before the beginning of the fiscal year (January) and the 2006 and 2007 budgets were approved in February and April, respectively.[31]

24. **The introduction of a new *GFSM 2001*-based economic classification on January 1, 2007 is a step further to make the budget presentation consistent with international standards.** *3.2.2*

---

[29] Under Decree No. 476 dated October 21, 2005.

[30] Article 40 of the *Law on Basic Principles of Budget in the Kyrgyz Republic* stipulates that the draft republican budget shall be developed in accordance with the budgeting schedule approved by the government.

[31] The 2006 and 2007 draft budgets were submitted to parliament on September 9, 2005 and August 30, 2006, but were only approved on February 9, 2006 and April 5, 2007, respectively.

Box 2. The Republican Budget Preparation Process

Due Dates	Activities	Legal/Regulatory Basis
February	The MoF issues the calendar for the preparation of the budget of the upcoming fiscal year	Article 11 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
May 1	The MoF submits the MTBF to the coordination council on macroeconomic and investment policy	Article 9 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
May	Based on the MTBF, the government approves and communicates the expenditure ceilings to line ministries, departments and agencies funded from the budget	Article 9 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
End June	Preparation of macroeconomic framework by the MoF	MoF order
July	Line ministries, departments and agencies submit their budget proposals to the MoF	MoF order
July-August	The MoF negotiates with the line ministries/budget units	MoF order
August	The MoF submits the draft budget to the cabinet for approval	Article 40 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
By September 1	The government submits the draft budget to parliament	Article 40 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
September	The parliamentary standing committee on budget and finance considers the draft budget	Article 41 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
By December	Parliament approves the budget	Article 42 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*
Within two weeks of budget approval by parliament and the president	The MoF publishes extracts of the approved budget in the press and on its website[1]	Article 12 of the *Law on Basic Principles of Budget Law in the Kyrgyz Republic*

[1] Although no due date for such publication is specified under the law, in practice, the extracts of the approved budget are put on the MoF website within two to three weeks.

The authorities have introduced a new economic classification based on the IMF *GFSM 2001* for budget management purposes starting with the 2007 fiscal year. However, teething problems were experienced with the implementation of the new classification, largely due to the inadequate preparation time allowed for updating the budget and reporting formats, training the staff, and developing comprehensive guidelines for implementation. Some implementation issues still remain unaddressed such as making changes to the chart of accounts to make it consistent with the budget classification and automating some of the processes in view of the increased workload. A new administrative classification system has also been introduced.

25. **A functional classification for budget presentation and reporting is yet to be introduced, and the economic classification is not being consistently applied.** *3.2.2*

The budget presentation still lacks a functional classification,[32] which makes it difficult to properly link the annual budget with the MTBF, which includes sectoral expenditure forecasts. Classifications for identifying the sources of funding and geographic location of transactions are also yet to be developed. The existing economic classification of expenditure is not being consistently applied across ministries[33] and some budgetary units.[34]

The macroeconomic framework and policy basis for the budget

26. **Although the overall balance of general government is the main indicator of the fiscal position in the budget, its monitoring during the year could be improved.** 3.2.3

The main focus of fiscal policy formulation in the budget is the overall deficit of general government. However, lack of a comprehensive and consolidated reporting of general government fiscal operations during budget execution creates difficulty in monitoring of the deficit target, particularly due to the exclusion of information about projects financed by donors.

27. **Budget forecasts are clearly presented in the budget, and their underlying macroeconomic assumptions are provided through an explanatory note.** *2.1.2*
The macroeconomic framework for the budget year and forecasts for next three years are prepared by the economic and financial analysis and forecasting department in the MoF. An explanatory note on the macroeconomic framework underpinning the budget is presented, which includes the key forecast figures and underlying assumptions. However, information on the methodology and forecasting models used are not explained in the budget. Also no external scrutiny or analysis of the macroeconomic framework or its underlying assumptions takes place.

---

[32] The authorities are planning to introduce a functional classification starting with the 2009 budget. For this purpose, the MoF has issued a order (No. 147-P) dated August 29, 2007 on functional classification, which has been registered with the Ministry of Justice and is likely to take effect on January 1, 2008.

[33] For example, with the introduction of a sector-wide approach (SWAP) as an alternative aid delivery mechanism—the modality through which donors channel their funds to a sector budget and both donors and the government coordinate their activities in the sector as opposed to there being a plethora of donors supporting a multiplicity of uncoordinated projects with no overarching framework—in the Ministry of Health, its expenditure allocations are combined under a single budget line without a break-up by economic categories. The Ministry of Health reallocates these funds independently among various economic categories and submits the report on cash execution of its budget with a breakdown as per economic classification codes used by the central treasury.

[34] The allocations under certain budget units such as the Centralized Fund for Poverty Reduction (CFPR) are clubbed under "other expenditures." The allocations under the CFPR are used by several budget-financed institutions based on decisions taken by the CFPR commission to implement various projects aimed at poverty reduction. The expenditures on these projects are reported with a breakdown by economic classification items.

28. **The macroforecasts and their underlying assumptions come too late in the budget process to feed into the MTBF and provide timely guidance to the ministries and budget units.** *2.1.2/4.1.1*
There are separate processes for preparing the macroeconomic framework and the MTBF. While the MoF prepares the MTBF in April for submission to the coordination council by May 1 each year, the macroeconomic framework is finalized only by end-June (see Box 2 above). This sometimes necessitates changes to the MTBF and line ministries/budget units are informed of the updated macroeconomic indicators only by end-June to adjust their draft budget proposals.

29. **With the recent creation of the MEDT, the government agency responsible for preparing macroeconomic forecasts is likely to change.** *2.1.2*
The MEDT has been created by a government decree with the mandate to prepare macroeconomic forecasts and formulate the fiscal policy of government.[35] It could not prepare the macroeconomic forecasts in time for the 2008 draft budget, which is based on the MoF forecasts. However, the MEDT is likely to be the lead agency responsible for preparation of the macroeconomic forecasts from the 2009 budget onwards.

Medium-term planning and analysis of fiscal risks

30. **A statement on medium-term fiscal policy objectives is not included in the budget document, and fiscal sustainability issues are not presented.** *2.1.2/2.1.4*
However, the MTBF document includes medium-term fiscal targets, and the MoF plans to include a medium-term fiscal policy objective statement in the 2009 budget. Although some of the existing policy commitments of the government have a future financial impact, the fiscal sustainability of such policies and programs are not systematically analyzed and presented. One such example is the pension liabilities and unemployment and other benefits under the *Law on State Social Insurance* and the *Law on State Pension*. The lowering of the retirement age in 2007 has created additional liabilities, which are planned to be met through transfers from the budget and improved contribution collection. It is unclear, however, how such expenditures would be financed in later years in a sustainable manner.

31. **There is an MTBF which is updated in May/June each year, but its projections are yet to be based on fully costed expenditure policy proposals.**[36] *2.1.3*
The government just issued a 2008–10 MTBF (see Box 3). The annual budget includes estimates for two forward years under broad revenue and expenditure categories. However, the costs of government policies and programs are yet to be tracked with an acceptable degree of accuracy to serve as the basis for a well-developed forward estimates system and systematic preparation of the MTBF. Moreover, the current and capital budgets are still not well integrated. Capital expenditure is split between the special means budget

---

[35] These functions and responsibilities were vested with the MoF before the creation of the MEDT.

[36] The process of updating the MTBF is integrated with the annual budget preparation calendar (see Box 2).

Box 3. MTBF in the Kyrgyz Republic

- The MTBF in the Kyrgyz Republic covers a three-year period. The latest MTBF (2008–10) contains the following: (i) a description of the macrofiscal framework and forecasts; (ii) an analysis of sectoral expenditures; (iii) a medium-term strategy for fiscal policy; (iv) a forecast on servicing of public debt; (v) sectoral expenditure strategies, including an expenditure ceiling for each sector; and (vi) a note on the quasi-fiscal deficit in the electric energy sector.
- For guidance of the sectoral ministries as well as divisions within the MoF, a methodology manual on preparing the MTBF for 2008–10 was prepared and circulated by the MoF.
- The MTBF is discussed and approved at a session of the coordination council on macroeconomic and investment policy headed by the prime minister.
- The MTBF document is published as a brochure and placed on the website of the MoF. This has been done for the last three years.

and the development budget, and there is no systematic assessment of the future recurrent expenditure requirements of the present capital investments, including those that are financed externally.

32. **No fiscal rule is used in the budget process.** *2.1.2*

There are no explicit fiscal rules guiding fiscal policy formulation and implementation.

33. **Estimates of the cost of new initiatives and of ongoing government policies are not clearly distinguished in the budget documents.** *2.1.3*
There are, however, general statements on new government priorities and large expenditure programs in the MTBF document (which is approved by the government, but not presented to parliament).

34. **The budget documents do not include an analysis of the sensitivity of budget estimates to changes in economic variables and contain no information or discussion of fiscal risks.** *2.1.4/3.1.3*
There are no data or discussion of fiscal risks related to macroeconomic variables or QFAs. No statement describing the nature and significance of government contingent liabilities, including a statement on government guarantees, is included with the budget. There is also no system of systematically assessing the risks associated with explicit government guarantees, including the probability of guarantees being invoked and their possible fiscal impact.

Clarity of control of budget execution

35. **Basic accounting procedures are in place, with some limitations, and expenditure control is mostly focused at the payment stage.** *2.2.1*
Accounting and reporting on budget execution are discussed below (paragraphs 44–46). The treasury is responsible for executing both the republican and local budgets. It has a central treasury unit and 65 regional treasury units subordinated to the central treasury. The treasury is regulated under the *Law on the Principles of Treasury* and other regulations/instructions such as the *Instructions on Revenue Management,* the *Instructions*

on Expenditure Management, and the *Instructions for Opening and Management of Accounts in Local and Territorial Treasuries.* The treasury applies expenditure controls only at the payment stage when it processes the payment requests received from budget institutions. However, there is partial *ex ante* control on allocation of cash resources to budget units through the issuance of monthly financial plans by the treasury.

36. **There is a lack of proper commitment controls in the Kyrgyz Republic, and expenditure payment arrears, which sometimes emerge, are not systematically reported.** *2.2.1*
There is no system of recording and controlling commitments either by the treasury or by budget institutions, although the latter are supposed to report on commitments[37]. The only information available to the treasury are the monthly requests for financing received from the budget institutions.[38] If the monthly financial plan issued by the treasury falls short of actual cash requirements by budget institutions, it sometimes leads to payment arrears. There have been instances of arrears being accumulated, particularly for utilities payments, by budget institutions using their appropriations for other purposes. Such arrears are not systematically tracked and reported.

37. **The treasury controls the cash balances of most government bank accounts and the bank account structure is largely integrated.** *2.2.1*
Most bank accounts used to process budget receipts and payments are controlled by the treasury, with some exceptions.[39] The treasury controls two current accounts (one for so-called budgetary transactions and the other for special means transactions of the republican and local government units), one foreign currency account, and 49 other special accounts.[40] Although each of these accounts hold individual cash balances, the total cash balance under all these accounts is taken as part of the government's consolidated fund.

38. **Financial management practices are mostly coordinated, but cash expenditure forecasting could be more usefully linked to the central bank's liquidity management.**

---

[37] A column on "Commitments and Contracts" was incorporated recently into the format used for reporting by budget institutions. The authorities plan to introduce from 2008 a system of recording and controlling commitments.

[38] These requests for financing are received by the first day of the respective month and serve as the basis for the preparation of a monthly financial plan, which is approved by the minister of finance and communicated to regional treasury units and budget institutions.

[39] The exceptions are the bank accounts that are required by international agreements to be controlled separately and the foreign currency bank accounts outside the Kyrgyz Republic that are controlled by its embassies.

[40] These special bank accounts include: separate accounts for depositing the sale proceeds of government equity shares in Centerra Gold (the accumulated cash balances in this special account are generally appropriated under the centralized fund for poverty reduction) and the Taldybulak gold deposit, a separate account for U.S. military base operations, and a separate account for sovereign debt repayments. The total number of such special accounts could vary from year to year.

2.2.1

The preparation of monthly financial plans by the treasury are coordinated with the revenue department, the debt management department, and the PIP division in terms of updating forecasts of revenue, loan disbursements, and flow of grants/credits for externally funded projects, respectively. However, the treasury's monthly financial plan and cash forecasting system is yet to contribute effectively to the NBKR's liquidity forecasting system by providing a systematized schedule of payments for the week ahead.[41]

39. **Although some progress has been made, the internal audit function is yet to be fully developed.** *4.2.5*

Currently, the financial control unit (established in April 2007) within the MoF carries out inspections in ministries, budget units and regional treasury units mostly focusing on legal compliance of expenditure. Internal audit units have also existed in a number of line ministries for some time, generally due to donor conditionalities.[42] However, there is a lack of legal and regulatory framework governing internal audit, and the capacity continues to be very low for application of modern audit practices. The government has taken some recent initiatives for internal audit reform, which includes the establishment in 2006 of a new division of internal audit and accounting methodology within the MoF, submission of a draft internal audit law to parliament[43], preparation of draft standards for internal audit and an internal audit manual, and training workshops for accountants and auditors.

40. **Procurement rules mostly conform to international best practice, but some problems with their implementation remain.** *1.2.4/4.2.3*

The 2004 *Law on Procurement* provides the legal framework for procurement by government agencies. Under the law, all budget institutions are required to have procurement units manned by qualified staff, and contracts above a certain threshold amount[44] are subject to approval by a tender commission following competitive procurement procedures. The state committee on public procurement (SCPP) monitors the implementation of procurement rules in budget institutions. Its website (www.goszakupki.gov.kg/english) disseminates information about tenders and contract awards. Although there is a sound legal framework for procurement, its implementation remains weak. Problems with the existing public procurement arrangements have been

---

[41] In the absence of information on a projected schedule of payments at least for the week ahead, there is uncertainty as to the (major value) cash payments to be made in the near term which complicates liquidity management by the central bank. The authorities, however, have introduced a practice this year to submit the monthly financial plans (including both revenue and expenditure) prepared by the treasury to the central bank.

[42] Ministries of health (both for the ministry and the health insurance fund), labor, social protection, and agriculture are examples.

[43] The draft internal audit law, which was prepared with donor assistance, was submitted to parliament in September 2007.

[44] Currently, this threshold amount has been set at 100,000 soms.

documented in some depth in other reports, and include: few procuring entities have qualified procurement staff; others use a permanent tender commission, which is not consistent with the prevailing law; difficult access to bidding documents, which are of poor quality; short bid preparation time allowed to bidders; cancellation of contract awards without justification; and frequent amendments to contracts during contract performance.[45] Moreover, the controls are weak for contracts below the threshold amount for tenders, and there is a risk of splitting contracts to escape scrutiny of large purchases by the ministerial tender commissions.

41. **Despite recent initiatives, the existing civil service employment arrangements are still problematic.** *4.2.2*
Recent initiatives include the enactment of a *Law on Civil Service* and the creation of a civil service agency in 2004. The definition of civil servants under this law, however, does not cover all categories of employees who are paid salaries through the budget.[46] The government sector continues to have several separate wage systems under a fragmented regulatory framework for various categories of employees in different ministries and budget institutions. Although the percentage of civil service appointments bypassing an open competitive process has decreased markedly in recent years, the scope for discretion in recruitment and promotion continues, due to complex and non-standardized rules. The other problems documented in recent studies of the civil service include: problems in recruitment and retention of qualified staff; ad hoc setting of pay rates for civil servants, with pay supplements accounting for up to 50 percent of total compensation; lack of a comprehensive database of civil servants; and the payroll data not being linked to personnel records.[47]

Clarity of internal control and independence of tax administration

42. **The tax authorities are working to improve internal monitoring and control mechanisms.** *4.2.6*
Although there is little computerization (especially in regional tax offices), the STC signed an agreement with the Asian Development Bank in August 2007 governing a US$10 million grant to modernize and computerize the tax office. As part of this initiative, the committee will establish a call center to provide information, answer questions, and help register taxpayer concerns. An internal audit function exists, and there are plans for internal audits of field operations.

---

[45] World Bank, *Country Fiduciary Assessment Update*, June 2007.

[46] The *Civil Service Law* deals with only one category of civil servants called state administrative servants. Other government employees paid through the budget, such as those working in the ministry of internal affairs, the ministry of emergency, and the tax and customs departments, are covered under several special laws.

[47] World Bank, *Technical Note on Kyrgyz Republic Civil Service: Pay and Employment Analysis* under the on-going *Programmatic Public Expenditure Review* (PPER II), 2007.

43. **The STC is given legal protection from political interference.** *4.2.6*
The STC is organized independent of the MoF and has ministerial status. It publishes information on its website (www.sti.gov.kg).

Accounting and reporting on budget execution

44. **The accounting system is capable, with some difficulty, of producing accurate in-year reports on state budget executed by the treasury**. *2.2.1*
The central treasury and regional treasury units produce monthly reports on republican and local government budget outturns respectively. The monthly budget execution reports are published on the treasury's website (www.kazna.gov.kg) by the end of the following month. These monthly budget execution reports are not derived from the accounts of budget institutions, but from the treasury's accounting records.[48] The accounting system, however, does not provide accurate consolidated data on budget arrears in a timely manner. Arrears data are supposed to be maintained by the budget institutions themselves, but are not consolidated and reported for centralized decision-making.

45. **The treasury follows a single-entry accounting system, and its chart of accounts differs from that followed by budget institutions (see Box 4).** *4.1.2*
The Treasury and budget institutions essentially follow two different accounting systems, and there is a lack of consistency between the two. While the treasury's accounting system incorporates the new budget classification (introduced in January 2007), the chart of accounts for budget institutions does not include budget classification codes. This creates difficulty for reconciling the two sets of accounts and for ensuring that the accuracy of the reports is of an internationally-accepted level and quality. The practice of making accounting entries after the receipt of bank statements also defeats the purpose of reconciling the general ledger with the bank statements, and conflicts with a basic principle of modern accounting. The accounting methodology department under the MoF is currently developing a draft unified chart of accounts with donor assistance, which would incorporate the new budget classification and be used by the treasury as well as budget institutions.

46. **Fiscal reporting appears to cover most if not all general government.** *3.1.1/3.1.4*
The treasury system covers both the republican and local government budgets. Several off-budget funds have been progressively integrated into the treasury system. The special means revenue and expenditure transactions of budget institutions are also processed by the treasury. However, significant part of general government operations still remain outside the control of treasury. These include externally-financed project expenditures and some internally-financed expenditures, such as social fund operations and health sector expenditures financed through copayments. General government fiscal reports are

[48] The budget execution reports prepared by the treasury cover only operations passing through the treasury system and, therefore, do not fully reflect foreign-financed development spending (see also paragraphs 17 and 45).

Box 4. Budget Execution Accounting in the Kyrgyz Republic

Budget accounting by the treasury

- Accounting procedure is stipulated under the *Instructions on Accounting by the Treasury* issued by the MoF.
- It is cash-based.
- It is on a single-entry basis and lacks the controls inherent to double-entry accounting.
- Commitments are not recorded or consolidated by the treasury nor reported in budget execution reports.
- It incorporates the newly introduced (January 2007) budget classification.
- The accounting entries are made after receipt of bank statements, which conflicts with a basic principle of modern accounting.
- The treasury general ledgers at regional treasury offices contain individual accounts for each budget institution to monitor allocations authorized by the central treasury and to track actual payments vis-à-vis allocations.

Financial accounting by budget institutions

- It is on partial accrual basis, but the accrual basis does not conform to international standards, and the system is reliant on manual record keeping.
- The accounting procedure is stipulated under the *Instructions on Accounting by Budget Institutions* issued by the MoF.
- It uses a double-entry system.
- It does not include budget classification codes.
- It is mostly done manually and is labor intensive.

produced by consolidating the reports from the treasury, the social fund, and the PIP division of the MoF (for externally financed project expenditures). Although the quality of consolidation of general government fiscal data has improved substantially, further work remains to be done.[49] Also, a comprehensive assessment of the status of government-controlled organizations for inclusion within the general government sector has not yet been undertaken.

47. **The legislature receives monthly budget execution reports, but does not undertake a formal mid-year budget review.** *2.2.2*
The monthly budget execution reports are prepared by the treasury after aggregating the data received from 65 regional treasury units located in oblasts and rayons.

48. **The consolidated annual budget execution report is submitted to parliament within six months after the end of the fiscal year, but is not subject to external audit beforehand.** *2.2.4*

[49] For example, the entire expenditure under some reserve funds (such as the president's reserve fund, the state or government reserve fund, the governors' reserve funds at the local government level, and the centralized fund for poverty reduction) are still grouped under the category "other expenditures," and externally-financed project expenditures are shown for the total amount without a breakdown by economic categories.

Article 45 of the *Law on Basic Principles of Budget* stipulates that the annual report on budget execution shall be submitted to parliament by May 15 of the following year together with an explanatory note. Accordingly, the government submits the unaudited annual budget execution report simultaneously to both the parliament and the COA.[50] The audit report of the COA is generally received by September or October each year. Parliament adopts an *Annual Law on Budget Execution* based on the annual budget execution report submitted by the government, the audit report of the COA, and the report of the parliamentary standing committee on budget and finance.

49. **The treasury prepares annual financial statements based on data received from budget institutions, but their coverage, quality and timeliness need substantial improvement.** *2.2.4/3.1.5/4.1.2*
These statements include information on: revenues and grants; expenditures according to budget classifications, with comparisons between budget and outturns; cash balances in treasury bank accounts; the stock of public debt; and fixed assets of budget institutions. However, these statements are neither prepared on a timely basis,[51] nor audited by the COA. They do not include, inter alia, information on the stock of government financial assets, payables/arrears, or contingent liabilities. The reliability of the disclosures made in these statements is also undermined by undeveloped accounting systems in the treasury and budget institutions. No reconciliation is carried out between these statements and the cash-based budget execution reports submitted to parliament.

Results-oriented budgeting and reporting

50. **The objectives and expected results from government activities are discussed in budget documents only in general terms.** *3.2.4*
Although some progress has been made in preparing sectoral strategies and programs as part of the MTBF, the budget formulation process mostly focuses on inputs, and the budget documents presented to parliament say little about policy or program objectives. No performance information—performance measures or indicators—is made available. A sound program classification system will have to be in place as a precondition to moving towards a performance-based budgeting system.

C. Public Availability of Information

51. **The authorities make fiscal information available to the public, and there is a commitment to provide information at scheduled times, but it is not comprehensive.** *3.3.1/3.3.2*
There is no legal framework that requires the publication of the republican and local budgets. Nonetheless, this information is accessible on the MoF website (www.minfin.kg), one to two weeks after approval by parliament. These postings do not, however, include

[50] The annual report on state budget execution is prepared after consolidating data received from regional treasury units, which are required to reconcile their reports with those of budget institutions.

[51] The latest statements are available only for the fiscal year 2005.

the explanatory notes that discuss the macroeconomic framework and its underlying assumptions. The National Statistics Committee (NSC) publishes the monthly fiscal outturns of government, using treasury reports, with occasional delays.[52] The government prints brochures that explain the budget. Information on extrabudgetary funds, like the social fund and the medical insurance fund, are available on the websites of the government units that administer these funds. The MoF website also contains information on public debt (see paragraph 58). No consolidated information on government assets is made public.

The coverage and quality of budget documents

52. **Although the budget documents cover most central government fiscal activities, they still do not reflect QFAs, and analytical content requires further improvement.** *3.1.1/3.1.4*
The main budget documents include inter alia: (i) the budget estimates by major revenue and expenditure categories; (ii) the main macroeconomic forecasts, such as aggregate growth and inflation; (iii) the fiscal deficit and its financing; and (iv) some explanatory notes. Information on donor-financed projects is also disclosed. Although the overall debt and financing data are indicated in the budget, a public debt management report, covering both internal and external debt, is not included. The budget also does not include a medium-term fiscal policy objective statement nor statements of QFAs and contingent liabilities. The annual budget law is published on the MoF website (www.minfin.kg).

53. **Defense expenditures are included in the budget presented to parliament.** *3.1.1*
Defense transactions are presented in the budget in the same format and classifications as used for other types of spending.

Past and forecast fiscal data in the budget

54. **The budget document discloses the main revenue and expenditure aggregates for two years prior to the budget year and forecasts for the next two years.** *3.1.2*
These data are provided in tables, including tax and nontax revenues components, and expenditures by major economic categories. As far as past data is concerned, actuals for the year preceding the prior year and original appropriations rather than estimated outturns for the prior year are provided.

Budget treatment of off-budget fiscal activity

55. **No statement on contingent liabilities is included in the budget documents.** *3.1.3*
No information on contingent liabilities, such as loan guarantees granted by the

[52] Although the NSC receives tax collection data from the state tax inspectorate and the state customs inspectorate, the agency does not reconcile this information with treasury data and uses the treasury report as the only source.

government, is presented in the budget documents (see also Para 34). However, the public debt department within the MoF maintains a register of government guarantees.

56. **Statements of tax expenditures are not included in the budget documents.** *3.1.3*

However, the STC and the SCC compute the foregone revenue from exemptions. These are included in the internal reports they submit to the MoF.

57. **QFAs are extensive and their estimated cost is not included in the budget documents.** *3.1.3*

The quasi-fiscal deficit in the energy sector is estimated at between 5 and 6 percent of GDP in 2006. While discussed in a chapter of the MTBF, a description of this deficit is not included in the budget documents. In the financial sector, the QFAs of two state-owned commercial banks, Ayil Bank and the SSC, are not mentioned in the budget documents. There is no information on their cost.

Publication of data on debt and financial assets

58. **Information on gross public debt is published on the website of the MoF.** *3.1.5*

The information includes external debt by individual creditors and by level of concessionality; domestic debt by instrument and maturity; and contingent liabilities by individual creditors and original debtor. There is no breakdown of debt by remaining maturity and currency.[53] A section that lists and describes loan agreements is also updated semi-annually. There are plans to post explanatory notes starting in October 2007. The MoF coordinates on the compilation of debt data with the central treasury, NBKR, and the PIP unit in the MoF, which has information on bilateral debt through commercial banks. External debt is also reconciled with loan agreements and disbursement invoices. Projections of debt service and new borrowing are included in the budget.

59. **Information on government financial assets is not published.** *3.1.5/3.1.6*

Several government units receive data of financial assets in the course of fulfilling their functions. The state property fund monitors equity holdings in state-owned enterprises, but it does not prepare a consolidated statement. The MoF possesses data on external loans of state-owned enterprises. The state fund for economic development, in its task to oversee payments of government credit, keeps a database of government loans to domestic companies. However, these are not fully consolidated nor discussed in budget documents or internal reports.

Commitment to timely publication of fiscal data

60. **Formal commitments for more regular publication of fiscal data have been made and advance release data calendars are announced.** *3.3.1/3.3.2*

[53] All external debt is long term. There is also no breakdown of type of interest rate, as close to 100 percent of debt has a fixed interest rate. The government has neither debt swaps nor arrears.

The Kyrgyz Republic subscribed to the IMF's Special Data Dissemination Standard (SDDS) in February 2004 and complies with SDDS requirements to produce advance release calendars. Updates of the advance release calendar have been timely. The data are disseminated on the 20th of every month, on the website of the MoF (www.minfin.kg). SDDS requirements for timeliness were met or exceeded in 2006 for publication of general government operations, central government operations and central government debt. The data are produced from accounting records and reports of the treasury. While the timing of the provision of annual budget execution reports to parliament, and therefore their public release, is laid down in the *Law on Basic Principles of Budget*, there is no such requirement for in-year reporting.

D. Assurances of Integrity

Integrity of data processes

61. **The credibility of the budget is still low, as the variance between budgeted and actual outturns have been considerable and partially disclosed to the public.** *4.1.1*
As a result of the unreliability of budget estimates, the average difference between budgeted and actual expenditures (for major functional categories) exceeded 20 percent of original budgeted expenditure over the three years 2002, 2003, and 2004.[54] The process by which budget funds are reallocated or increased during budget execution is not clear and reportedly ad hoc in the absence of clear virement rules. This reduces the credibility of the budget as the main policy instrument. **The in-year budget execution reports also do not show a comparison between the budgeted and actual expenditures.**[55] Although deviations between budget estimates and outturns are explained in the final accounts, such deviations are calculated with reference to the final adjusted figures and not the original appropriations.

62. **Statements on accounting policy are not included in the budget or final accounts documents.** *4.1.2*
Accounting practices, which differ between the treasury and budget institutions, have been described above, and they do not meet international standards. Financial accounting at the level of budget institutions is mostly manual. USAID has been assisting the authorities in the introduction of cash-based International Public Sector Accounting Standards (IPSAS); however, there have been no recent developments in government accounting standards.

63. **The process of accounts reconciliation and fiscal reporting is largely effective with some limitations (see Box 5)**. *4.1.3*
Bank balances are reconciled monthly on both aggregate and detailed levels. As noted in Box 4, the quality of the reconciliations between budgetary accounts and financial

---

[54] Oxford Policy Management, *Kyrgyz Republic: Public Expenditure and Financial Accountability Assessment (PEFA)*, January 2006.

[55] The adjusted figures of budgetary allocations also change continuously during the year in the absence of clear virement rules.

Box 5. Reconciliation Processes in the Kyrgyz Republic

- For cash payments, the treasury cross-checks data contained in daily bank statements and compares them with payments authorized. At the end of every month, the treasury balances are reconciled at the aggregate level for daily operations of receipts and payments in the bank account. There is effectively no check float, as the checks issued by the treasury are valid for just one day.
- All tax revenues are required to be transferred daily by the collecting banks to the treasury's account with one of the three agent banks. The treasury accounting takes place on receipt of the daily bank statements, and a formal reconciliation between the treasury and the bank is carried out at the end of every month. The regional treasury units transmit data on revenues collected under various categories of taxes and fees to the respective regional state tax and customs committees[56]. However, arrangements to monitor any delay between the date of collection of revenue by the bank and its transmission to the relevant treasury bank account seem inadequate. The treasury is informed of the delay only when the bank indicates the remittance on its bank statement.
- No suspense accounts are maintained by the treasury. The payment and receipt transactions are accounted for only after the final purpose of the transaction is known. For certain categories of temporary advances, such as travel, it is only the budget institutions, which keep records and monitor their adjustment.
- The cash-based budgetary accounts of the treasury and partially accrual-based financial accounts of budget institutions are reconciled every month. However, the divergent accounting methodology of these two sets of accounts renders their reconciliation difficult and undermines the accuracy of consolidated accounts prepared by the treasury at the end of every month.

accounts is undermined by the different accounting systems of the treasury and budget institutions and the largely manual system of recording and consolidation both at the regional treasury offices and the budget organizations. The reconciliation of debt and deficit data between the fiscal and monetary accounts, including between above- and below-the-line figures, requires improvement. The data reconciliations are not shown explicitly in accounting reports.

Independent oversight

64. **The external audit is fairly independent of the executive branch, and its mandate covers all public sector activities.** *4.3.1*
The COA is established by the constitution as the national audit institution of the Kyrgyz Republic.[57] The constitution (Article 80) and the *Law on the Chamber of Accounts* endow it with a broad mandate to audit the execution of republican and local budgets, non-budget funds, and the use of state and municipal property. The constitution (Articles 46 and 58) and the *Law on the Chamber of Accounts* stipulate that the president and parliament each

[56] There is also a process of monthly reconciliation between the State Tax Committee and State Customs Committee on the one hand, and the regional treasury units on the other, in the form of certificates of reconciliation exchanged between the departments.

[57] Subsequent to the fiscal ROSC mission in September 2007, a new constitution was approved in a nation-wide referendum held on October 21, 2007.

appoint half of all auditors of the COA and dismiss them.[58] The appointment of the chairman of the chamber is made by the president and approved by parliament. The COA submits its audit reports to both the president and parliament. Amendment of the *Law on the Chamber of Accounts* in 2004 (No. 117 of August 2004) resulted in some changes with regard to the chamber's role, staffing and budget.[59] It has the right to set up its own staffing structure and its budget (a separate line in the republican budget) is determined by a parliamentary committee. The word "control" under the earlier law was also replaced with "audit." The COA audits each budget institution/agency once every two years, although some agencies are audited on an annual basis. It does not provide any certification of final accounts, neither for individual agencies nor for the government as a whole.

65. **Strengthening of audit capacity is required.** *4.3.1*
The COA has about 190 staff, including staff at its regional units. The technical capacity of the staff is still limited, and a lack of training and exposure to modern auditing practices by the staff hampers an effective implementation of the COA's audit mandate. It remains largely an inspection and control unit that carries out periodic checks to ensure compliance with existing regulations, including the public procurement law.[60]

66. **The legislature discusses external audit reports, but does not systematically follow up on audit findings.** *4.3.2*
The audit reports of the COA are presented to parliament and the president. The parliamentary committee on budget and finance discusses the annual audit reports, but since there is a time lag of up to six months between the submissions by the government of the annual report on budget execution and the audit report by the COA respectively, the committee hires independent experts to provide an opinion on the government's annual report on budget execution. Under Article 45 of the *Law on Basic Principles of Budget*, parliament is required to review the report of the COA before approving the government's report on budget execution. The parliament, however, does not systematically follow up on audit findings to ensure that adequate actions are taken to address the issues identified in its review. The COA has a website (www.ach.kg) where extracts of its reports are published, but the general public does not have access to the COA's audit reports.

67. **External scrutiny of macroeconomic models and assumptions is not encouraged.** *4.3.3*
As the budget data are made publicly available only after approval of the budget, this constrains independent analysis and comments on the quality of fiscal data included in budget documents, especially regarding macroeconomic and macrofiscal forecasts, at the

[58] Either the president or the parliament can dismiss only the auditors specifically appointed by each of them and not vice versa.

[59] Some further amendments to the law have recently been proposed.

[60] Oxford Policy Management, *Kyrgyz Republic: Public Expenditure and Financial Accountability Assessment (PEFA)*, January 2006.

stage of parliamentary discussions. There is little public discussion of this topic. The model used by the MoF for the macroeconomic forecasts underpinning the budget is not made publicly available. Information about some key assumptions is, however, available in explanatory notes appended to the budget.

68. **The NSC is given legislative assurance of independence.** *4.3.4*
The *Law of the Kyrgyz Republic on State Statistics* provides the basis for the autonomy and independence of the NSC in the compilation of national statistics. The law explicitly prohibits interference by central and local governments. Moreover, appointment and removal from office of heads of lower-level statistical offices can be undertaken without the approval of the local self-government bodies. The chairman of the NSC is appointed by the President of the Kyrgyz Republic. The NSC publishes data on its website (http://www.stat.kg) as well as in paper bulletins. The Kyrgyz Republic subscribes to the SDDS and meets the timetable for providing data on monthly and annual state government operations and quarterly debt information.

III. IMF Staff Commentary

69. **Since the initial fiscal transparency ROSC was published in 2002, the Kyrgyz Republic has undertaken a series of actions leading to improved transparency of fiscal policy and fiscal management**. The availability to the public of fiscal information, including on public debt, has strengthened and there is now a formal commitment for more regular publication, including through the announcement of advance release calendars. The Kyrgyz Republic subscribed to the IMF's SDDS in 2004 and met SDDS requirements in 2006. Most of the extrabudgetary funds and special means have been integrated into the budget. The integration of policy choices into the budget process has improved through the preparation of rolling three-year MTBFs with expanding sectoral coverage. Budget outturns and forecasts for prior and future years are now clearly presented in the budget. Budget presentation has improved with the introduction of a new budget classification based on *GSFM 2001*. The 2004 *Procurement Law* provides a legal framework for procurement by government agencies in line with international best practice. The relations between the MoF and the NBKR have been clarified, and there have been efforts to quantify and document the extent of QFAs in the energy sector. Resource revenue transparency has been enhanced through a commitment to implement the EITI.

70. **At the same time, there are several areas where further progress in transparency is needed:**

- The definition of government activities is complicated by the use of special means, the creation of a development fund with a mandate to undertake some public policies through transfers from the budget, and the lack of a detailed statement of QFAs in (financial and nonfinancial) areas where the government continues to have substantial involvement. This is exacerbated by a general lack of oversight of state-owned joint stock companies.

- Transparency in intergovernmental fiscal relations has been affected by lack of a consistent and stable legal framework, while the revenue and expenditure assignments are effectively decided on an annual basis.

- Coordination of fiscal management could be adversely affected by the transfer of some responsibilities of the MoF to the ministry of economic development and trade.

- Fiscal reporting lacks comprehensive statements on medium- and long-term fiscal policy objectives, fiscal risks, QFAs, tax expenditures, and financial assets.

- Transparency in budget execution is undermined by the lack of a clear framework to introduce changes to the budget, differing accounting practices, and weak commitment controls.

- Internal control and audit practices are still not consistent with international standards.

- Policy with respect to the pay structure and terms and conditions for employment of government staff is fragmented. Management of personnel and payroll is not integrated, which undermines payroll control and runs the risk of *ghost* workers.

71. **The following are key recommendations to further improve fiscal transparency in the Kyrgyz Republic and help meet the standards of the fiscal transparency code in the areas of clarity of roles and responsibilities, openness of the budget process, and assurances of integrity of fiscal data.**

Clarity of roles and responsibilities

- Clearly demarcate the boundaries between the general government sector and the broader public sector. The Kyrgyz Republic should continue recent efforts to identify the actions of general government and integrate them into the budget, in line with the *GFSM 2001*. Initiatives like the creation of a development fund could dilute such a demarcation. The proper and comprehensive identification of government functions (i.e., those related to the implementation of public policy through the provision of nonprofit/nonmarket services) helps to establish clear accountability and facilitates assessment of the macroeconomic impact of fiscal policy.

- Ensure a strong central role by the MoF in fiscal management and fiscal policy formulation. The recent restructuring of the government structure and the reassignment of some key responsibilities away from the MoF run the risk of fragmenting fiscal policy design and of reducing coordination in its implementation.

- Develop a comprehensive framework for overseeing state-owned joint stock enterprises. The SPC, which has focused more on the design and implementation of privatization programs, should (i) ensure that companies with state equity participation publish audited financial statements consistent with international standards and including auditors' comments, and (ii) prepare consolidated financial statements and reports on state-owned companies for the government and parliament. This should help to inform policy makers and the public of the extent of the government's participation in the economy, to identify QFAs undertaken by these enterprises, and to allow for assessment of potential fiscal risks.

- Elaborate a consolidated legal framework to overcome the inconsistencies and fragmentation that has characterized intergovernmental fiscal relations. Such a framework should lead to a more permanent system for revenue sharing, intergovernmental transfers, and assignment of expenditure responsibilities across different levels of government. This might be a gradual process requiring broad political consensus.

- Adopt clear virement rules for reallocation of budgetary appropriations from one category to another during the year.

Budget preparation and presentation

- Enhance the link of the MTBF with the annual republican and social fund budgets by: (i) advancing the timing of preparation and dissemination of macroeconomic forecasts and their underlying assumptions; and (ii) incorporating a consolidated presentation of revenue and expenditure outcomes and forecasts of both the republican and social fund budgets.

- Strengthen the preparation of the MTBF and the reliability of forward budgetary estimates by detailing the cost of new initiatives and of ongoing government policies, and by improving the costing of government policies and programs.

- Introduce a functional classification for budget presentation and reporting, and apply the economic classification consistently across all ministries and budget units.

- Improve budget documentation by: (i) adding a statement on medium-term fiscal policy objectives; (ii) including an assessment of the fiscal risks arising from potential changes in the main macroeconomic assumptions underlying the submitted budget; (iii) detailing contingent liabilities and individual quasi-fiscal operations; (iv) providing an estimate of tax expenditures; (iv) reporting the size and composition of government assets; and (v) including a report assessing the fiscal impact of medium- to long-term policy commitments, such as public pension programs.

Budget execution control, accounting, and reporting

- Strengthen the expenditure control function by designing and implementing a comprehensive commitment control system through the treasury. Box 6 provides further details about the concept of commitment control.

- Develop systematized schedules of expenditure payments (at least for major value cash payments to be made in the week ahead) based on the treasury's financial plan to contribute to the NBKR's liquidity forecasting system.

Box 6. The Concept of Commitment Control

Commitment means an obligation to effect a future payment subject to the fulfillment of certain conditions (contractual or otherwise). [1] There are two main types of commitments: (i) specific commitments; and (ii) continuing/running commitments. Specific commitments are those that will require a single payment or a definitive series of payments over a determinate period of time. These include contracts for goods and services, or any similar arrangement, and occur when a formal action is taken by a line ministry/agency, such as placing an order for supply of goods and services, issuing a local purchase order, or awarding a contract. Continuing commitments are those that will require a series of payments or settlement actions over an indeterminate period of time, and might not involve a specific contract. These include wages, utilities, scholarships, entitlement payments, and other similar arrangements.

Commitment is the critical stage of the expenditure process. Controlling commitments is essential for controlling expenditure. The key objective of commitment control is to manage the initial incurrence of obligations, rather than the subsequent cash payments, in order to enforce expenditure ceilings and avoid expenditure arrears. To this end, the commitment control system imposes limits on commitments. The limits on commitments can be based on budget appropriations or on cash plans. Ideally, commitments should be regulated by annual budget appropriations. However, this approach proves to be insufficient in preventing the incurrence of arrears, in case of revenue and financing shortfalls. Commitment control based on expenditure ceilings or cash limits reconciles the availability of resources with commitments, thus ensuring that spending units enter only into contracts or other arrangements for which sufficient unencumbered balances are available or are likely to be available at the time of their payments. It is necessary that expenditure ceilings are guided by a well functioning cash management system.

---

[1] Sometimes, what is interpreted as a "commitment" is at best a reservation, that is, the request from a spending unit to put aside an allotment for a future expenditure. This cannot be considered a commitment in accounting terms, because no contract is signed at this stage. Commitments need also to be distinguished from payables that arise at the verification stage when goods have been delivered or the service has been rendered according to the contract and the invoice for payment to the supplier has been received.

- Introduce an internal audit function in line with accepted international internal auditing standards and integrate this carefully with other public financial management and public administration reforms.

- Adopt a comprehensive cash accounting system, incorporating an unified chart of accounts (for use by the treasury as well as budget institutions) consistent with the budget classification, in a double-entry based general ledger.

- Expand the coverage of fiscal reporting by including operations that still remain outside the treasury control, such as foreign-financed development spending, as well as the information on commitments and the outstanding stock of arrears in the context of the preparation of monthly and quarterly budget execution reports.

- Prepare consolidated annual financial statements within six months of the close of each fiscal year. These should include inter alia full information on the stock of public debt, financial assets, receivables, payables, fixed assets, and contingent liabilities, and should be subject to audit and certification by the COA.

- Introduce a harmonized framework for regulating the pay structure and terms and conditions of employment of government staff. Integrate personnel and payroll management systems to eliminate the risk of *ghost* workers.

Assurances of integrity

- Strengthen the external audit function by upgrading the capacity of the COA staff in modern auditing approaches and techniques and by making available COA reports and findings to the general public.

72. **This report includes the first assessment of practices against the *Guide on Resource Revenue Transparency* in the Kyrgyz Republic.**

- Roles and responsibilities are partially but not completely clear. The *Constitution of the Kyrgyz Republic* states that subsurface resources are the property of the state. A number of laws and regulations define the legal framework for exploration and development of subsurface resources. The government owns shares in a number of resource companies through state-owned, joint stock companies. Extrabudgetary funds generally are not used. On the other hand, the degree of discretionary authority held by the government in licensing is significant, and the process of tendering is not sufficiently transparent. Legislation does not require full disclosure of resource-related revenue, loan receipts and liabilities, and asset holdings.

- The budget process generally does not include explicit consideration of resource revenues in budgeting, managing assets, and assessing fiscal risks. This omission may partly stem from the smaller role that resource revenue plays in government financing in the Kyrgyz Republic compared to a number of other countries whose governments are highly dependent on oil and/or mining revenue.

- There is mixed but growing public availability of information. Resource revenue-related transactions are reported, but only some are clearly identified and described in the budget process and final accounts documents. The Kyrgyz Republic committed to implement the EITI, but implementation progress has been slow.

- In the area of assurances of integrity, international resource companies comply with internationally accepted standards of accounting, auditing, and publication of accounts; Kyrgyzaltyn does not. With the approval of the government of the Kyrgyz Republic, the NSC reports regularly on revenue flows between international and national companies based on the data of companies and as part of the EITI implementation process. However, it does not reconcile differences between the data of companies and the government, and the information is not audited independently.

73. **In the context of these findings, the following recommendations should help improve transparency in this area:**

- Further review the licensing procedures for exploration and development, beyond the clarifications of Decree 336 issued in 2007, to reduce government's still significant discretionary authority in, for example, granting a license, defining its length, extending an existing license, or converting an exploration license to a production license. Similarly, tendering procedures should be clarified to reduce the degree of government's discretionary authority. In particular, it would be important to better articulate when a tender needs to occur and to make public the terms of winning offers.

In the case of both licenses and tenders, procedures for dispute resolution should be clarified.

- Prepare and publish comprehensive, audited financial statements consistent with international accounting standards for Kyrgyzaltyn and the other state-owned companies in the resource sector, as part of the overall recommendation that clear monitoring systems be established for managing state-owned companies.

- Fully implement the EITI. At present, there is only partial implementation—collecting data from both companies and the government, and publishing the information from companies without reconciling any differences with government data. Full implementation of the EITI will require independent reconciliation and auditing of the data.

- Consider a more systematic integration of resource revenue issues in budget preparation and reporting. Even though resource-related revenues do not yet represent a large share of total government revenue, a case could be made to: (i) introduce an explicit policy statement on management of resource revenues in budget documentation; (ii) identify explicitly resource-related revenue; (iii) include medium-term resource revenue projections; (iv) introduce the (primary) nonresource fiscal balance as an additional fiscal indicator to assess the fiscal stance and help undertake fiscal sustainability analysis; and (v) explicitly discuss the fiscal risks associated with resource revenues.

Appendix I. Resource Revenue Transparency

Clarity of roles and responsibilities

The government's ownership of resources in the ground is clearly established in the constitution. *1.2.4/1.2.5*

1. The 2003 *Constitution of the Kyrgyz Republic* states that mineral resources are the property of the Kyrgyz Republic. One exception is identified in the 1997 *Law of the Kyrgyz Republic on the Subsoil* (as amended) which states that minor deposits at the surface may be in communal or private ownership.

2. The power to grant rights to explore, produce, and sell these resources is established in laws, regulations, and procedures that cover all stages of resource development.[1] However, the government has a large degree of discretion in licensing, and the tendering process is not as transparent as it should be.

- Various laws and a number of supplementary regulations define rights and responsibilities in this area, including the *Law on the Subsoil*, *Law on Oil and Gas*, *Law on Coal*, and *Law on Agreements on Production Sharing*. All these laws have been developed and implemented since the mid-1990s. The *Law on Subsoil* has been amended three times, most recently in 2006. While generally clear, they are not without ambiguity. For instance, there are inconsistencies in how terms are defined that could cause confusion and misunderstanding in the future.[2] Private and public companies, domestic and foreign, are authorized to conduct exploration and production, as long as they are registered in the Kyrgyz Republic. The Kyrgyz Republic retains the priority right to buy precious metals and oil and gas produced within the country. Any international agreement that establishes rules other than those in the *Law on Subsoil* supersedes this *law*.

- The 2003 *Investment Law* defines terms under which foreign investment occurs and includes the provision that foreign and domestic investors will receive equal treatment. The 2002 *Concessions Law* defines procedures for granting concessions to foreign investors that generally are more difficult to obtain than the licenses described below, but which also have more limited grounds for termination by the government. The Kumtor mine, described below, operates under a concession.

[1] At the time this assessment was prepared, a broad-based group of business leaders and government officials was working to prepare a proposal for reforming mining legislation and regulation in the Kyrgyz Republic with the aim of clarifying roles and responsibilities of the various parties and improving the functioning of activity in the mining sector.

[2] In places, these laws refer to terms and practices that were part of the legal and operating environment during Soviet times—for example, the Soviet system of reserve classification, the need for the government to evaluate the economic feasibility of a project prior to issuing a license, and the requirement that a deposit be exploited optimally in a technical rather than in an economic sense.

- Licensing for subsoil resources is regulated by Decree 336 issued in 2007, which establishes that rights to deposits of national importance, as determined by the government, will be granted through tenders and auctions. For all other properties, most importantly for properties to be prospected and explored, licenses are awarded through direct negotiation with the government. In both cases, the state agency for geology and mineral resources (SAGMR) is responsible for the licensing process. There is no standard investment agreement.

- The SAGMR has a large degree of discretion in whether to grant a license, in defining its length, and in deciding whether to extend a license. The granting of a license depends on preparation of a work plan approved by the agency. The length of a license for prospecting and exploration is initially for two years with possible extension up to ten years when the work plan established in the license agreement is completed to the satisfaction of the agency. For a development (mining or production) license, the length is determined by the agency. A license is only transferable with approval of the agency. Dispute resolution is defined only in general terms. The rules do not clearly describe the process for converting an exploration license into a production license or the criteria used to determine whether to approve the conversion.

- The SAGMR administers the tendering process, appointing a separate commission for each tender. The commission, in turn, defines the terms of the tender and invites offers. It reviews the tender offers and selects the winner based on simple majority. The winner is publicly announced, but—significantly—not the terms of the winning bid.

- The SAGMR is responsible for monitoring and reviewing the activities of mining operations, along with the environmental protection agency and the commission on security (which is responsible for worker health and safety). The agency's authority relative to regions and local communities is clear, although some regions and local communities would like relatively greater authority.

The government's policy framework and the legal basis for taxation or production sharing agreements with resource companies are presented to the public clearly and comprehensively. *1.2.2/1.2.4*

3. The fiscal regime governing resource extraction is mainly defined by the 1996 *General Tax Code*, the 1997 *Foreign Investment Law*, and the *Law on Subsoil*.[3]

- There is no specialized tax regime for the extractive industries. As such, extractive industries are subject to profit tax, revenue-based taxes (including road and emergency fund taxes), and several production and input taxes (including land, withholding, customs, value-added, and contributions to the social fund, which goes toward medical care and pensions). In addition, Decree 198 issued in 1997 defines a charge that companies have to pay for the replenishment of the minerals and raw materials base,

[3] At the time this report was written, there were discussions and proposals to revise the tax code.

which is effectively a royalty based on gross revenues with rates ranging from 2 to 10 percent.[4]

- The 2002 *Law on Agreement of Production Sharing* permits the government to enter into production-sharing agreements with private companies. To date, it has not been used.

- The main tax incentives and rules that apply to the extractive industries are depreciation, carryover of losses, and tax exemption for dividend income received by legal entities that are resident in the republic. Tax holidays and tax stability (or stabilization) are not part of the general tax system, although they were negotiated in the past for at least one project, the Kumtor mine (see Box 7). Ringfencing exists in the sense that exploration expenditures only within the boundaries of a specific license are deductible expenses.

- The Kumtor gold mine operates under a fiscal regime linked to the general tax rules, but one that was negotiated directly with the government, and significantly, will become essentially independent of general tax rules if a proposed new agreement is approved. This mine is the largest foreign investment in the Republic. The mine is about to enter its third ownership and operating structure. The renegotiated agreement needs to be approved by the Kyrgyz Parliament, as well as the boards of directors of both Centerra and Cameco.

Fiscal authority over resource-related revenue and borrowing is clearly specified in the law. Legislation does not include a requirement for full disclosure of all resource-related revenue, loan receipts and liabilities, and asset holdings. *1.2.2*

4. The state tax inspectorate collects all resource-related revenue. Government participation in the mining sector is mainly channeled through joint stock companies. In principle, shareholders of a joint stock company are not responsible for any obligations of the company, and conversely, the company is not responsible for obligations of its shareholders. However, the government can decide to assume or guarantee debt by those companies. The *Law on Joint Stock Companies* requires public disclosure of financial statements only when the number of shareholders is more than 500; thus, Kyrgyzaltyn and other fully state-owned mining companies in the Kyrgyz Republic are not legally required to publicly disclose financial information. Joint stock companies are required to prepare audited financial statements and submit them to shareholders and to the Kyrgyz authorities. Although there is no legal requirement for complete transparency of revenue flows and borrowing, the Kyrgyz Republic committed in 2004 to implement the EITI with Resolution 361, *On Measures for Mining Sector Activity Transparency Improvement* (see paragraph 16).

---

[4] This mineral and raw materials tax is not earmarked for any particular use, despite the reference to "replenishment" in its name.

Box 7. Kumtor Mine

A major gold deposit was developed in the 1990s with production beginning in 1997 by Kumtor Gold Company, in which Cameco, a Canadian company, had a one-third interest and Kyrgyzaltyn, a Kyrgyz state-owned company, owned the remaining interest. Cameco operated the mine under a master agreement completed with the government in 1992 prior to the enactment of most existing legal and fiscal rules of the Republic. The parties to this agreement were Cameco, the Kyrgyz Republic, and Kyrgyzaltyn. The terms of this agreement were publicized, although it does not appear that the actual agreement is public information. The terms included an initial tax holiday of five years on profit tax.

In December 2003, Cameco and Kyrgyzaltyn announced their agreement to restructure the company so that it became a wholly owned subsidiary of a new company, Centerra Gold, based in Canada and listed on the Toronto Stock Exchange. At present, Cameco owns slightly more than half the shares in Centerra, Kyrgyzaltyn holds about one-sixth of the shares, and public investors worldwide own the remaining shares. The mine operates under an investment agreement the parties to which are Cameco, Kyrgyzaltyn, and Kumtor Gold Company. The main elements of the original master agreement continue in the investment agreement. Although the investment agreement itself does not appear to be public information, Centerra Gold described many of its features in the prospectus associated with the initial public offering of Centerra shares in 2004. In particular, the investment agreement states that Kumtor Gold Company will be subject only to taxes in existence on December 31, 2003. The agreement calls for all gold doré produced at the mine to be sold to Kyrgyzaltyn for refining, based on the price of refined gold on the London Bullion Market. Kyrgyzaltyn receives a management fee for services rendered of US$1.50 per ounce of gold produced, after an initial payment of US$1 million. As part of this restructuring, Kyrgyzaltyn reduced its shareholding in the company and received payment of more than C$100 million.

In August 2007, the Kyrgyz government and Centerra Gold announced that they had reached a new agreement for the Kumtor mine. Negotiations were in response to public concern that the Kyrgyz Republic does not receive sufficient benefits from the mine and to threats in parliament earlier in the year to nationalize the mine. The proposed agreement has three major elements. First, the ownership structure will change so that Kyrgyzaltyn's share increases to about 30 percent and Cameco's share falls to about 40 percent. Kyrgyzaltyn will receive its additional shares by means of a free transfer of shares from Cameco, as well as through the issue of additional shares by Centerra, diluting the value of existing shares by about 5 percent. Second, the existing tax regime will be replaced with a simpler scheme consisting of only one type of payment—a tax on gross revenues at rates of 11 percent in 2008, 12 percent in 2009, and 13 percent thereafter. Third, Kumtor's concession will be enlarged to include prospective areas adjacent to the existing concession area.

While government involvement in the resource sector through equity participation is fully disclosed, the implications are not explained to the public. *1.1.5/1.2.4*

5. There are a number of resource-related companies owned totally or in part by the Kyrgyz Republic. Among the more important are: Kyrgyzaltyn, primarily active in gold mining; Khaydarkan Mercury Enterprise; Kyrgyzneftegas, oil and natural gas; Ak-Ulak, coal; and Sulyuktakomur, coal. They are organized as joint stock companies under the *Law on Joint Stock Companies*. Government ownership is disclosed by the SPC. However, in practice there is no clear monitoring system for state-owned enterprises. Wholly owned joint stock companies, such as Kyrgyzaltyn, are required by the *Law on Joint Stock Companies* to pay no less than 25 percent of net profits as dividends, unless another arrangement is made with the unanimous approval of shareholders at the annual general meeting.

Ownership structures of national resource companies and their fiscal role vis-à-vis the resource sector ministry and the finance ministry are clearly defined; however, it

is not clear the extent to which commercial responsibilities are distinguished from policy, regulatory, and social obligations. *1.1.4/1.1.5*

6. As noted in paragraph 5, several important resource companies are organized as joint-stock companies with significant government ownership. Legally, they operate as holding companies and do not have fiscal responsibilities beyond adhering to the tax code and paying dividends at least equal to 25 percent of profits. Legally, the shareholders provide strategic direction and broad oversight of their companies. When the state is the sole shareholder, however, there is room for it to instruct the company to pursue noncommercial objectives. Kyrgyzaltyn has a stated objective of increasing gold output in the Republic.

There are no formal requirements that international or national resource companies undertake social or environmental expenditure or provide subsidies to producers or consumers without explicit budget support from government. *1.1.4/1.1.5*

7. In some cases, however, companies undertake such activities, often motivated by either pressure from local communities or the desire to foster good relations with the communities in which they operate. Kumtor Gold Company, for example, has a number of initiatives to support the mine region, including support for local craftsmen, a commitment to purchase agricultural produce locally, and the establishment of a microcredit fund to provide credit to small agricultural and business initiatives. The annual EITI reports noted in paragraph 16 contain data on company expenditures for infrastructure improvements and environmental protection. It is not clear, however, whether these expenditure are voluntary or required by government (or both).

Arrangements to assign or share resource-related revenues between central and subnational levels of government are limited and well defined, but not explicitly linked to resource revenues. *1.1.3*

8. The tax code includes an annual transfer of a percentage of profit tax revenues (including resource-related) from central to subnational levels of government. The percentage transferred is determined annually during budget discussions. The tax code does not refer specifically to resource revenues. The Kumtor Gold Company also pays 2 percent of profits to the Issykul Development Fund, administered by local authorities.

Open budget process

The budget framework does not incorporate a policy statement on the rate of exploitation of natural resources or the management of resource revenues, including long-term fiscal sustainability. *2.1.2/2.1.4*

9. This partly stems from the fact that, despite the relative importance of mining exports in total exports, mining-related revenue currently represents only some 7–10 percent of total government revenue.

Although extrabudgetary funds for managing resource revenue are generally not used, there are not clear rules as to the accrual of the resources, either to local governments or to an extrabudgetary fund. *2.1.5*

10. An example might be the Issykul Development Fund to which Kumtor pays 2 percent of profits. This fund is not administered by the national government, but rather by the local authorities. The proceeds of the sale of Centerra shares in 2004 were put into a special government account. They were to be used to fund priorities in the medium-term national poverty reduction strategy under the budget.

The overall framework for fiscal policy does not explicitly consider resource-related funds. *2.1.2/2.1.5*

11. However, examples of resource-related funds are the Issykul Development Fund (see paragraph 10) and the Development Fund (see footnote 6).

The investment policies for assets accumulated through resource revenue savings are not clearly stated, although there are few examples of such savings. *2.1.2/1.2.5*

12. One such example is the revenue from sale of Centerra shares. These proceeds are in a special account and do not appear to have been invested. These funds do earn interest.

The treasury publishes monthly revenue reports, which include but do not explicitly separate resource revenues from other revenues. *2.2.1*

13. The reports are prepared on a cash accounting basis.

Public availability of information

Most resource revenue-related transactions are reported but only some are clearly identified and described in the budget process and final accounts documents. *3.1.1/3.1.4*

14. Profit-tax revenues and dividends from resource-related industries are reported but not separately identified in the draft budget or final accounts. Taxes on the subsoil (the charge for replenishment of the minerals and the raw materials base) are reflected separately in budget execution documents but not in the draft budget, where they are included but not shown separately. Almost none of these receipts are earmarked, and thus they do not appear in isolation in expenditure accounts. The exception is proceeds from Centerra shares, which are set aside for the centralized fund for poverty reduction. The annual budget law states the amount to be withdrawn from this fund, as well as the projects these moneys will fund. Government-guaranteed debt is presented along with debt from other sectors on the website of the MoF; it is not reported in the budget process and final accounts documents.

Reports on government receipts of company resource revenue payments are only partially made public as part of the government budget and accounting process. *3.1.4*

15. Government receipts of profits and other general taxes are published in aggregated form (that is, receipts from resource companies are not presented separately). The mineral-specific charge that mining companies pay (described above in paragraph 3) is published separately.

16. Although the Kyrgyz Republic committed to implement the EITI, implementation has been only partial and delayed by changes in government.[5] To date, the Republic has: appointed an implementation committee (government officials) and an advisory council (comprising representatives from government, industry, civil society, and international organizations); agreed on a template for data collection and identified the six large companies from which data are to be collected; appointed the NSC to collect data from both companies and government; and collected and published some data for 2004, 2005, and 2006 (www.stat.kg/English/Sesituation/Default.html). These actions fall short of full implementation in that the NSC is a governmental entity, although it is independent of any ministry; there has been no reconciliation of differences between company and government data; the NSC has published only the company data with a footnote that these data are subject to change once they have been reconciled and audited; and there has been no independent audit of the data.

The (primary) non-resource fiscal balance is not presented in budget documents as an indicator of the macroeconomic impact and sustainability of fiscal policy, in addition to the overall balance and other relevant fiscal indicators. *3.2.3*

17. As discussed above, this is partly because of the low incidence of mining-related revenue on total government revenue.

Government reporting formats do not make provision for collateralized resource-revenue borrowing. *3.1.5*

18. Government debt reports do not include a US$4.4 million loan reported in Centerra's financial statements.[6] On the other hand, government reports do indicate that the government is guaranteeing a loan to Kyrgyzaltyn by a foreign bank.

Financial assets held by the government domestically or abroad as a result of resource-related savings are not fully disclosed in government financial statements.

[5] Full EITI implementation requires most importantly that: (i) companies and government both submit information on resource-revenue payments and receipts to an independent third party, (ii) the third party reconciles any differences between the two sets of data to international audit standards, and (iii) the third party publishes and discusses the data, including any discrepancies between company and government data.

[6] In December 2006, Centerra agreed to loan (interest free) the Kyrgyz Republic C$4.4 million to help the government make payments "to assist the government in fulfilling its responsibilities" in compensating members of local communities. C$3 million was disbursed in 2006, with the remainder to be loaned in 2007. C$2.2 million is repayable in 2010, with the remaining C$1.4 forgivable in 2012 if there is no default. The loan is secured with Centerra shares owned by Kyrgyzaltyn.

3.1.5

19. There is no proper disclosure of government's financial assets, whether or not these assets result from resource-related saving. As for state-owned joint stock companies, there are no comprehensive statements of their financial assets.

Estimates of resource asset worth based on probable production streams, clearly disclosing assumptions, are not prepared as a basis for fiscal policy. *3.1.5*

20. The state geology agency is the government entity in charge of estimating reserves. However, the government does not include estimates of resource asset worth in budget documentation or in its financial statements.

Government contingent liabilities and the cost of resource company quasi-fiscal activities arising from resource-related contracts are not reported in budget accounts or other relevant documents in a form that helps assess fiscal risks and the full extent of fiscal activity. *3.1.3*

21. Government reports suggest that there are no loans to state-owned mining companies guaranteed by the government, other than the loan to Kyrgyzaltyn guaranteed by the government noted above in paragraph 18. Government reporting formats do not make provision for collateralized resource-revenue borrowing. The annual EITI reports noted in paragraph 16 contain data on company expenditures for infrastructure improvements and environmental protection; there is no explanation, however, of whether these expenditures are voluntary or required by government (or both).

Risks associated with resource revenue, particularly price risks and contingent liabilities, are not explicitly considered in annual budget documents. *3.1.3*

22. As noted in paragraph 34 of the main ROSC text, budget documents do not include sensitivity analysis of budget estimates to changes in the underlying assumptions and do not contain information on fiscal risks.

Assurances of integrity

The internal audit function in government generally is yet to be fully developed, although some progress has been made. *4.2.5*

23. See paragraph 39 of the main ROSC text.

Tax administration is conducted in a way to ensure that resource companies understand their obligations, entitlements, and rights. *4.2.6/1.2.1*

24. The large taxpayer unit, with which most mining enterprises interact, was established several years ago and is working to enhance its effectiveness. On a specific issue, the price Kyrgyzaltyn pays for Kumtor gold doré, which is not priced on a

(transparent) world commodity exchange, is nevertheless based on the London Bullion Association price for refined gold.

International resource companies comply fully with internationally accepted standards for accounting, auditing, and publication of accounts. Kyrgyzaltyn does not comply fully with internationally accepted standards. Centerra Gold, which operates the Kumtor mine, fully complies with international standards. *4.3.1/1.1.5*

25. In its 2006 Annual Report (www.centerragold.com), the accounting firm KPMG found that Centerra was in compliance with Canadian generally accepted accounting principles. It audited Centerra's consolidated balance sheets and consolidated statements of earnings, retained earnings and cash flow. In addition, Centerra presented operating results and reserve and resource estimates for its wholly owned subsidiary Kumtor Gold Company. By contrast, Kyrgyzaltyn is not required by the *Law on Joint Stock Companies* to publish accounts for public viewing. On July 13, 2007, however, it did publish brief financial statements for calendar years 2005 and 2006 on the business page of the local newspaper *Slovokyrgyzstana*. The statements included a balance sheet and an income statement, audited by the local firm Hitech Audit Company, which concluded that Kyrgyzaltyn is "in compliance with International Standards of Financial Reporting." The statement did not include full financial accounts or the auditing comments of the audit firm. The *Law on Joint Stock Companies* does not give specific instructions on how an auditor is to be selected, and there is no comprehensive monitoring framework on state-owned companies by the SPC.

The NSC reports regularly on the revenue flows and other substantial payments between international and national companies and the government under EITI monitoring, but not on any discrepancies between different sets of data on these flows. *4.3.1*

26. Estimates of resource revenues received by government have been published for 2004, 2005, and 2006, under the EITI. At present, the NSC collects information from statistical reports of companies and the government, but does not reconcile any differences between different sets of data as the NSC lacks clear guidelines to compare them. It publishes only the data on resource revenues submitted by the companies.

Appendix II. Summary of Key Findings from Past Fiscal Transparency Assessments

A. 2002 Full ROSC

Overview

- Important steps taken to improve fiscal transparency in recent years, particularly in the area of budget preparation and execution.
- Internationally accepted standards of general government used as a basis for defining fiscal activities. However, there are difficulties in delineating private and public activities in practice.
- The fiscal relations between different levels of government are still emerging.
- Fiscal management is defined by a legal framework that is relatively complete.
- The public availability of past, current, and projected fiscal activity of the government is limited. Information on public debt is not systematically published.
- The annual budget document is rudimentary and with limited coverage.
- Some problems with treasury reporting and expenditure control remain.

Commentary

- The role and responsibilities within government and between government and the rest of the economy need to be further clarified.
- QFAs need to be identified comprehensively and reported as part of government activity.
- A review of budget documentation should be initiated, with a view of more systematically and comprehensively presenting fiscal information in budget documents that are provided to the parliament for the budget discussion.
- Annexes covering contingent liabilities, tax expenditures, and QFAs should be provided as part of the budget documents.
- A comprehensive presentation of forecasting assumptions and fiscal risks should be provided in the budget supporting documents.
- A mid-term budget review should be undertaken and a mid-year budget report should be presented to parliament within three months of the mid-year.
- Regular reporting standards should be established covering original and revised budget estimates for revenue, expenditure, and financing.

- The coverage and presentation of fiscal information available to the public should be improved. The public should be provided with full information on the past, current, and projected fiscal activities. Much of it could be done in the short-term since a sizable amount of information is already available at the MoF, but not published.

- Fiscal data should better meet accepted data quality standards and independent scrutiny of fiscal data needs to be improved.

B. November 2004 ROSC Update

- The authorities have regularized financial relations between the NBKR and the MoF based on a decree that took effect in June 2002. A scheme to restructure NBKR-held government bonds was developed, under which both government deposits at NBKR and NBKR claims on government carry positive interest rates.

- A new regulation expected to take effect in late 2004 would require that license fees, fines, penalties and other obligatory payments received by ministries and government agencies ("special means") are transferred to the budget and be processed directly through the treasury system and credited to the single treasury account. Since 2002, the central treasury holds a separate account at NBKR (and transit accounts at agent banks for the regional offices of the treasury) for "special means" that are not yet credited to the Treasury Single Account to manage operations under "special means."

- Four large extrabudgetary funds are gradually integrated into the treasury system, following the government action plan approved in June 2004.

- Pending the full automation of the treasury system, the cash forecasting function of the treasury has been improved. A cash forecasting unit was created within the central treasury in 2003.

- Significant improvements were made by the government in the publication of fiscal information. A monthly budget implementation report is available on the MoF website. The NSC subsequently publishes this information in its monthly statistical bulletin. The quarterly bulletin published monthly by the MoF since 2003 discusses issues related to budget preparation and execution and includes information on government debt.

- The budget planning process has improved significantly with the annual publication, beginning in 2003, of rolling three-year MTBFs.

- Little progress has been made to improve the reporting of the government QFAs. Publication of the electricity sector quasi-fiscal deficit in the MoF quarterly bulletin is a welcome exception.

IV. Summary Tables

Table 1. A Summary Assessment of Practices

	Principles and Practices	Summary Assessments	Comments
1.1.	**The government sector should be distinguished from the rest of the public sector and from the rest of the economy;**	*Largely not observed*	
1.1.1	The structure and functions of government should be clear.	General government is largely defined in line with government finance statistics (GFS) principles, and is mostly covered in the budget process.	However, the use of special means to promote the introduction of user charges and fees could complicate the definition of boundaries of the general government sector and its consistent coverage in the budget process.
1.1.2	The fiscal powers of the executive, legislative, and judicial branches of government should be well defined.	The fiscal roles of the executive, legislative, and judicial branches are defined in the constitution and relevant laws.	
1.1.3	The responsibilities of different levels of government, and the relationships between them, should be clearly specified.	The responsibilities of different levels of government are not clearly defined and varies from year to year.	Although the legal frameworks exist, they do not provide adequate guidance, are not always implemented, and are sometimes superseded by other laws.
1.1.4	Relationships between the government and public corporations should be based on clear arrangements.	The relationship between government and public nonfinancial and financial corporations are not always clear.	The extent of some quasi-fiscal activities are not made transparent. None are included in budget documentation.
1.1.5	Government relationships with the private sector should be conducted in an open manner, following clear rules and procedures.	Laws and processes governing government regulation of the nonfinancial private sector are not always clear and open.	Laws and regulations are often fraught with contradictions, giving regulators and government inspectors some discretion.
1.2.	**There should be a clear and open legal, regulatory, and administrative framework for fiscal management.**	*Largely observed*	
1.2.1	The collection, commitment, and use of public funds should be governed by comprehensive budget, tax,	The legal framework for management of public funds is	

	Principles and Practices	Summary Assessments	Comments
	and other public finance laws, regulations, and administrative procedures.	mostly clear, but risks fragmentation due to a likely division of fiscal management function between two ministries.	
1.2.2	Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner.	The legislative basis for taxation is clear and is comprehensive but the scope for interpretation and discretion by tax officials is significant.	The tax and customs code provide the legal basis for taxation and exemptions.
1.2.3	There should be sufficient time for consultation about proposed laws and regulatory changes and, where feasible, broader policy changes.	Consultations about proposed laws and regulatory changes are not always held.	
1.2.4	Contractual arrangements between the government and public or private entities, including resource companies and operators of government concessions, should be clear and publicly accessible.	The government has a large degree of discretion in licensing, and the tendering process is not as transparent as it should be.	
1.2.5	Government liability and asset management, including the granting of rights to use or exploit public assets, should have an explicit legal basis.	The power to grant rights to explore, produce, and sell these resources is established in laws, regulations, and procedures that cover all stages of resource development.	
2.1.	**Budget preparation should follow an established timetable and be guided by well-defined macroeconomic and fiscal policy objectives.**	*Largely not observed*	
2.1.1	A budget calendar should be specified and adhered to. Adequate time should be allowed for the draft budget to be considered by the legislature.	The key stages of the annual budget process are legally specified and the rest of the budget calendar is regulated by an order of the MoF each year.	
2.1.2 (a)	The annual budget should be realistic, and should be prepared and presented within a comprehensive	There is an MTBF which is updated every year, but its	The credibility of the budget is still low, as the variance between budgeted and actual outturns have been considerable

	Principles and Practices	Summary Assessments	Comments
	medium-term macroeconomic and fiscal policy framework.	projections are yet to be based on fully costed expenditure policy proposals	and partially disclosed to the public.
2.1.2 (b)	Fiscal targets and any fiscal rules should be clearly stated and explained.	No fiscal rule is used in the budget process. A statement on medium-term fiscal policy objectives is not included in the budget document, and fiscal sustainability issues are not presented.	
2.1.3	A description of major expenditure and revenue measures, and their contribution to policy objectives, should be provided. Estimates should also be provided of their current and future budgetary impact and their broader economic implications.	Estimates of the cost of new initiatives and of ongoing government policies are not clearly distinguished in the budget documents.	
2.1.4	The budget documentation should include an assessment of fiscal sustainability. The main assumptions about economic developments and policies should be realistic and clearly specified, and sensitivity analysis should be presented.	The budget documents do not include an analysis of the sensitivity of budget estimates to changes in economic variables and contain no information or discussion of fiscal risks.	
2.1.5	There should be clear mechanisms for the coordination and management of budgetary and extrabudgetary activities within the overall fiscal policy framework.	Foreign-financed development expenditure is not well integrated with budgetary operations, which complicates monitoring and fiscal management.	
2.2	**There should be clear procedures for budget execution, monitoring, and reporting**	*Largely not observed*	
2.2.1	The accounting system should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities, and assets.	There is a lack of proper commitment controls, and expenditure payment arrears, which sometimes emerge, are not systematically reported.	
2.2.2	A timely midyear report on budget developments should be presented to the legislature. More frequent updates, which should be at least quarterly, should be published.	The legislature does not undertake a formal mid-year budget review, but it does receive monthly budget execution reports.	

	Principles and Practices	Summary Assessments	Comments
2.2.3	Supplementary revenue and expenditure proposals during the fiscal year should be presented to the legislature in a manner consistent with the original budget presentation.	Supplementary budgets are presented to the legislature, but the process by which budget funds are reallocated/increased during budget execution is not clear in the absence of virement rules.	
2.2.4	Audited final accounts and audit reports, including reconciliation with the approved budget, should be presented to the legislature and published within a year.	The consolidated annual budget execution report is submitted to parliament within six months after the end of the fiscal year, but is not subject to external audit beforehand. It is not reconciled with the original budget.	The audit report of the COA is submitted to the legislature, but is not made available to the general public.
3.1	**The public should be provided with comprehensive information on past, current, and projected fiscal activity and on major fiscal risks.**	*Largely not observed*	
3.1.1	The budget documentation, including the final accounts, and other published fiscal reports should cover all budgetary and extrabudgetary activities of the central government.	Fiscal reporting appears to cover most if not all general government.	General government fiscal reports are produced by consolidating the reports from the treasury, the social fund, and the PIP division of the MoF.
3.1.2	Information comparable to that in the annual budget should be provided for the outturns of at least the two preceding fiscal years, together with forecasts and sensitivity analysis for the main budget aggregates for at least two years following the budget.	The budget document discloses the main revenue and expenditure aggregates for two years prior to the budget year and forecasts for the next two years.	However, no sensitivity analysis for the main budget aggregates is provided.
3.1.3	Statements describing the nature and fiscal significance of central government tax expenditures, contingent liabilities, and quasi-fiscal activities should be part of the budget documentation, together with an assessment of all other major fiscal risks.	No statement on contingent liabilities is included in the budget documents. Statements of tax expenditures are not included in the budget documents. QFAs are extensive and their estimated cost is not included in the budget	

	Principles and Practices	Summary Assessments	Comments
		documents.	
3.1.4	Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.	Most resource revenue-related transactions are reported but only some are clearly identified and described in the budget process and final accounts documents.	Externally-financed project expenditures are included in the budget documentation, but mostly remain outside the treasury control. The treasury's monthly revenue reports do not explicitly separate resource revenues from other revenues.
3.1.5	The central government should publish information on the level and composition of its debt and financial assets, significant nondebt liabilities (including pension rights, guarantee exposure, and other contractual obligations), and natural resource assets.	Information on gross public debt is published on the website of the MoF. Information on government financial assets is not published.	Estimates of resource asset worth are also not prepared/published.
3.1.6	The budget documentation should report the fiscal position of subnational governments and the finances of public corporations.	Apart from the general government balance, no information on the finances of public corporations is reported in the budget documentation. The fiscal position of local governments are reported.	Although the state property committee receives annual reports from state-owned joint-stock companies, it does not consolidate the information or submit a standard report to the government and/or parliament.
3.1.7	The government should publish a periodic report on long-term public finances.	No such report is published.	
3.2	**Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability.**	*Largely not observed*	
3.2.1	A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.	The government prints brochures explaining the budget and its composition.	
3.2.2	Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional,	Fiscal data is reported on gross basis and expenditure is classified by administrative and economic	The introduction of a new GFSM 2001-based economic classification is a step further to make the budget presentation consistent with international standards.

	Principles and Practices	Summary Assessments	Comments
	and administrative category.	category. The functional classification is still to be finalized.	
3.2.3	The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.	The overall balance of general government is the main indicator of the fiscal position in the budget. However, its monitoring during the year could be improved. The non-resource balance is not used.	Exclusion of information about projection financed by donors creates difficulty in monitoring the deficit target.
3.2.4	Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.	The objectives and expected results from government activities are discussed in budget documents only in general terms.	The budget formulation process mostly focuses on inputs, and the budget documents say little about policy or program objectives. No performance measures or indicators is made available.
3.3	**A commitment should be made to the timely publication of fiscal information.**	*Largely observed*	
3.3.1	The timely publication of fiscal information should be a legal obligation of the government.	There is no legal framework that requires the publication of the republican and local budgets.	Nonetheless, monthly information is accessible on the MoF website, one to two weeks after approval by parliament.
3.3.2	Advance release calendars for fiscal information should be announced and adhered to.	Formal commitments for more regular publication of fiscal data have been made and advance release dates for fiscal information are announced.	The Kyrgyz Republic subscribed to the IMF's Special Data Dissemination Standard (SDDS) in February 2004 and complies with SDDS requirements to produce advance release calendars.
4.1	**Fiscal data should meet accepted data quality standards.**	*Largely not observed*	
4.1.1	Budget forecasts and updates should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.	The macroforecasts and their underlying assumptions come too late in the budget process to feed into the MTBF and provide timely guidance to the ministries and budget units.	
4.1.2	The annual budget and final accounts should indicate the accounting basis used in the compilation and presentation of fiscal data. Generally accepted accounting standards should be followed.	Statements on accounting policy are not included in the budget or final accounts documents.	Accounting practices differ between the treasury and budget institutions and they do not meet international standards.

	Principles and Practices	Summary Assessments	Comments
4.1.3	4.1.3 Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions to historical fiscal data and any changes to data classification should be explained.	The process of accounts reconciliation and fiscal reporting is largely effective with some limitations.	Bank balances are reconciled monthly on both aggregate and detailed level. However, the quality of the reconciliations between budgetary accounts and financial accounts is undermined by the different accounting systems of the treasury and budget institution and the largely manual system of recording and consolidation.
4.2	**Fiscal activities should be subject to effective internal oversight and safeguards.**	*Largely observed*	
4.2.1	Ethical standards of behavior for public servants should be clear and well publicized.	Some initiatives have been taken to regulate the conduct of public servants.	The Kyrgyz Republic participates in the Istanbul Anti-Corruption Action Plan. It has established a national agency for the prevention of corruption.
4.2.2	Public sector employment procedures and conditions should be documented and accessible to interested parties.	Despite recent initiatives, the existing civil service arrangements are still problematic.	The scope for discretion in recruitment and promotion continues due to complex and non-standardized rules.
4.2.3	Procurement regulations, meeting international standards, should be accessible and observed in practice.	Procurement rules conform to international best practice, but some problems with their implementation remain.	Problems include: few procuring entities have qualified procurement staff; others use a permanent tender commission; difficult access to bidding documents; short bid preparation time allowed to bidders; cancellation of contract awards without justification; and frequent amendments to contracts during contract performance.
4.2.4	Purchases and sales of public assets should be undertaken in an open manner, and major transactions should be separately identified.	The legal framework for privatization is clear; and privatization processes and payments of receipts to the budget are broadly clear.	The government formulates a privatization program, which it submits to parliament for approval. Privatization proceeds are reflected as financing in the budget.
4.2.5	Government activities and finances should be internally audited, and audit procedures should be open to review.	Although some progress has been made, the internal audit function is yet to be fully developed.	There is a lack of legal and regulatory framework governing internal audit, and the capacity continues to be very low for application of modern audit practices.
4.2.6	The national revenue administration should be legally protected from political direction, ensure taxpayers' rights, and report regularly to the public on its activities.	Tax administration is clearly defined and is mostly coordinated with overall fiscal management. The STC and SCC now are independent entities with ministerial status.	The STC has a unit providing taxpayer services, which maintains a website and periodically places information for taxpayers in the mass media.

	Principles and Practices	Summary Assessments	Comments
4.3	**Fiscal information should be externally scrutinized.**	*Largely not observed*	
4.3.1	Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.	The external audit is fairly independent of the executive branch, and its mandate covers all public sector activities.	However, it does not provide any certification of final accounts. The technical capacity of the staff is limited.
4.3.2	The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.	The legislature discusses external audit reports, but does not systematically follow up on audit findings.	
4.3.3	Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions.	External scrutiny of macroeconomic models and assumptions is not encouraged.	The budget data are made publicly available only after approval of the budget. The model used by the MoF for the macroeconomic forecasts underpinning the budget is not made publicly available.
4.3.4	A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.	The NSC is given legislative assurance of independence.	The *Law of the Kyrgyz Republic on State Statistics* explicitly prohibits interference by central and local governments.

Table 2. Public Availability of Information—A Summary

	Budget and fiscal report element	Included in budget/report documents	Available to the public	Para. ref.	Code ref.
1.	Central government (CG) budget estimates.	Yes	Yes	46	2.1.1
2.	CG defense expenditures	Yes	Yes	47	2.1.1
3.	CG EBFs (Social Fund)	Yes	Yes	46	2.1.1
4.	CG budget outturns	Yes	Yes	45	2.1.1
5.	CG budget forecasts	Yes	Yes	25, 48	2.1.2
6.	CG contingent liabilities	No	Some contingent liabilities in the form of government-guaranteed debt are accessible in the MoF website.	49	2.1.3
7.	CG tax expenditures	No. Calculations are made for internal use.	No	50	2.1.3
8.	CG QFAs	No. Energy sector QFAs are, however, discussed in the MTBF.	No	51	2.1.3
9.	Macroeconomic assumptions	Yes	No	24, 46	2.1.1 & 3.1.3
10.	Analysis of fiscal risks/sensitivity analysis	No	No	25, 28, 51	3.1.5
11.	CG debt	No.	Yes. Information is presented in the MoF website.	42, 52	2.1.4
12.	CG financial assets	No	No	54	2.1.4
13.	Sustainability analysis	No	No	25	2.1.1 & 3.1.1
14.	General government budget estimates	No. The Social Fund budget estimates are reported separately.	No	46	2.1.5
15.	CG monthly reports on fiscal outturn	Yes	Yes	38, 45	3.4.1
16.	General government quarterly reports on fiscal outturn	No. Monthly reports are submitted to Parliament and presented in the Ministry of Finance website.	No	45	3.4.1
17.	CG final accounts	Yes	Yes	42, 45	3.4.2
18.	Consolidated general government final accounts	No	No	42, 45	3.4.2