Document of
The World Bank

Report No: T 7345-RU

TECHNICAL ANNEX TO THE
MEMORANDUM OF THE PRESIDENT

RUSSIAN FEDERATION
REGIONAL FISCAL TECHNICAL ASSISTANCE PROJECT

November 30, 1999

Poverty Reduction and Economic Management Unit
Eastern Europe and Central Asia
CURRENCY EQUIVALENTS

Currency Unit = New Ruble (Rb)

MICEX Exchange Rates
New Ruble per US$1

<table>
<thead>
<tr>
<th>Period Average</th>
<th>End of Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>4.566</td>
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<td>1996</td>
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<td>1997</td>
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<tr>
<td>1998</td>
<td>9.355</td>
</tr>
<tr>
<td>1999*</td>
<td>24.130</td>
</tr>
</tbody>
</table>

* As of November 30, 1999

ABBREVIATIONS AND ACRONYMS

FER  Foundation for Enterprise Restructuring
CAS  Country Assistance Strategy
EHDP Enterprise Housing Divestiture Project
GDP  Gross Domestic Product
GOR  Government of Russia
FMD  Fiscal Monitoring Division
IMWG Inter-Ministerial Working Group
LIBOR London Inter-Bank Offered Rate
MOF  Ministry of Finance
OED  Operations Evaluation Department
PDL  Portfolio Development Loan
PHRD Program for Human Resources Development
PMU  Project Management Unit
PPF  Project Preparation Facility
RFTAP Regional Fiscal Technical Assistance Project
SAL  Structural Adjustment Loan
SPIL Social Protection Implementation Loan
TA  Technical Assistance
TAL  Technical Assistance Loan
USAID United States Agency for International Development

FISCAL YEAR
July 1 - June 30

Vice-President: Johannes F. Linn
Country Director: Michael F. Carter
Sector Director: Pradeep Mitra
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RUSSIAN FEDERATION 
REGIONAL FISCAL TECHNICAL ASSISTANCE PROJECT

TABLE OF CONTENTS

I. RATIONALE FOR BANK INVOLVEMENT .................................................... 1
   A. Major Impediments to the Reforms of Inter-Governmental Relations .......... 1
   B. GOR Agenda for Inter-Governmental Fiscal Reform ................................... 2
   C. Rationale for Bank Involvement ............................................................. 3
   D. Lessons from Previous Bank Involvement ............................................... 3

II. THE PROJECT ......................................................................................... 5
   A. Project Objectives .................................................................................... 5
   B. Project Description .................................................................................. 5
   C. Summary Project Analysis ....................................................................... 7
   D. Project Benefits ....................................................................................... 8
   E. Project Risks ............................................................................................ 8

III. PROJECT COST, FINANCING, MANAGEMENT AND IMPLEMENTATION .... 10
   A. Project Cost ............................................................................................. 10
   B. Borrower’s Financial Contribution ......................................................... 12
   C. Procurement ............................................................................................. 13
   D. Disbursements ......................................................................................... 15
   E. Project Implementation: Management Structure ....................................... 17

ANNEXES

   Annex 1. Performance and Monitoring Indicators ........................................... 26
   Annex 2. Procurement Plan ........................................................................... 28
   Annex 3. Terms of Reference for Technical Assistance ................................. 33
   Annex 4. Supervision Plan ........................................................................... 55
   Annex 5. Project Implementation Plan ............................................................ 57
I. RATIONALE FOR BANK INVOLVEMENT

A. Major Impediments to the Reforms of Inter-Government Fiscal Relations

1. Weak Fiscal and Structural Adjustment Reforms at the Sub-National Level

The Russian Federation has undergone significant reforms in its system of inter-governmental fiscal relations since the beginning of the transition. The Budget Code, approved by the Duma in 1998, and Part I of the Tax Code, which went into effect in January 1999 are examples of major Government efforts to reform fiscal management and budgeting at the sub-national level, as well as the existing system of revenue and tax assignments. While the pace and depth of reforms had accelerated in the first half of 1998, the August crisis brought these government efforts to an abrupt halt. However, in 1999, the Government’s attempts to reform inter-governmental fiscal relations have received a new, strong impetus. An Inter-Ministerial Working Group (IMWG) for Inter-Governmental Fiscal Reform has been formed and meets regularly, a Government Fiscal Concept Paper has been approved and has been adhered to, and a working dialogue with the regions on key issues of inter-governmental reform has been resumed. Yet, Russia’s fiscal and structural adjustment reforms at the sub-national level have been alarmingly slow. In many instances the progress of federal fiscal reforms has been reversed by the increased allocation of subsidies to the housing sector and enterprises from the regional and municipal budgets. From small surpluses in the early 1990s, most regional budgets have slipped into deficits. Sub-national government interest payments due in 1998 amounted to about 0.74 percent of GDP, and much of this was never paid. The August 17, 1998 ruble devaluation and the subsequent economic crisis triggered a chain of defaults by the regions on locally traded debt. As a result, a clear imbalance has developed between fiscal adjustment efforts at the federal and sub-national levels, posing a serious threat to Russia’s macroeconomic stability and impairing national economic growth. At present, the Government’s efforts to accelerate fiscal and structural reforms at the sub-national level are being hampered by three issues:

- **Deficient Legal Framework.** The current inter-governmental legal framework does not provide incentives throughout the multi-tiered fiscal system for effective tax collection, efficient allocation of public resources, and financially responsible borrowing. Lack of clarity in expenditure assignments and the extensive use of unfunded expenditure mandates from upper-level governments promote inefficient expenditure patterns and fiscally irresponsible behavior. In addition, the overall legal framework governing the system of inter-governmental fiscal relations is riddled with inconsistencies and contradictions.

\[1\] Part II of the Tax Code is still under discussion.
• **Poor Compliance.** Although over the past six years many laws have been passed on budgeting and financial management, revenue sharing, transfers, and assignment of functional responsibilities, there has been considerable variation in the degree of compliance with these laws by the regions. Enforcement of these laws remains weak. In some cases, the laws have been little more than proclamations, with essentially no implementation.

• **Weak Institutional Capacity.** The Government faces severe capacity constraints in the design and implementation of inter-governmental fiscal reforms, as well as in monitoring the compliance of the regions with federal regulations. The institutional capacity of the regions to implement fiscal and budgetary reforms is of even more concern, as the federal reform agenda grows ever more complex.

**B. GOR Agenda for Inter-Governmental Fiscal Reform**

2. The GOR recognizes that these issues must be addressed as part of its medium-term economic agenda. The GOR’s medium-term economic strategy includes actions to eliminate unfunded mandates from the federal to sub-national governments, revise the formula for allocating federal equalization transfers to the regions, and develop a program to rationalize expenditure and tax assignments with the objectives of establishing a more stable and transparent system of inter-governmental finance and providing a potential revenue base at each level of government commensurate with its respective responsibilities.

3. In order to implement its reform agenda in the area of inter-governmental fiscal relations, the GOR requested Bank financing to support the following Government efforts:

• Promote legal reform of inter-governmental fiscal relations, including fiscal management and budgeting, debt management, revenue and tax assignments, assignment of expenditures, and inter-governmental fiscal transfers;

• Build a powerful fiscal incentive mechanism to improve regional compliance with federal rules and regulations. As part of this effort, the Project will support further Bank efforts to promote fiscal and structural reforms in the regions;

• Improve regional institutional capacity to design, implement and monitor fiscal reforms. The Government believes the Bank can provide valuable technical support to the Fiscal Monitoring Division of the Ministry of Finance (FMD), which would focus on monitoring regional compliance with Federal legislation and provide analytical support and policy advice on inter-governmental fiscal issues to the Inter-Ministerial Working Group for Fiscal Reform. In addition, the Government requested the Bank’s assistance in designing and implementing complex budgetary and structural reforms at the regional level required by the Government reform program.
C. Rationale for Bank Involvement

4. The proposed Regional Fiscal Technical Assistance Project is fully consistent with the objectives of the Russia Country Assistance Strategy (CAS) due to be presented to the Board in conjunction with this operation, and with operational standards for project quality in that it:

- responds to the Government’s request for assistance in facilitating fiscal adjustment at the sub-national level;
- contributes to the structural reform program by identifying the priorities of public sector spending and expenditure programs for alternative provision by the private sector;
- promotes more equitable and efficient public spending through improvements in the legal framework of inter-governmental fiscal relations;
- builds institutional capacity for fiscal and economic management at the federal and sub-national levels, which is a key structural reform priority.

D. Lessons from Previous Bank Involvement

5. Major related projects financed by the Bank and/or other development agencies (completed, ongoing and planned) are described below:

<table>
<thead>
<tr>
<th>Sector Issue</th>
<th>Project</th>
<th>Latest Supervision (Form 590 Ratings (Bank-financed projects only)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Implementation Progress (IP)</td>
</tr>
<tr>
<td>Bank-financed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional fiscal management</td>
<td>Community Social Infrastructure Project (2 pilot regions will receive technical assistance for financial management)</td>
<td>U</td>
</tr>
<tr>
<td>Reform of expenditure and debt management</td>
<td>Management Skills for Market Development Project (National Training Foundation): public finance training component</td>
<td>S</td>
</tr>
<tr>
<td>Inter-governmental fiscal relations</td>
<td>Enterprise Housing Divestiture Project</td>
<td>U</td>
</tr>
<tr>
<td>Other development agencies</td>
<td>SAL III</td>
<td>U</td>
</tr>
</tbody>
</table>
6. The Bank brings experience with sub-national fiscal management, reform of inter-governmental fiscal relations, and reform of housing and communal services in other transitional and middle-income countries. The proposed approach under the project would draw on Bank experience accumulated from previous operations (both adjustment and investment projects), including those developed for other economies in transition. One important lesson from other Bank projects in Russia (e.g., EHDP, Urban Transport, Housing, and St. Petersburg Center City Rehabilitation Project) is that reform developments at the sub-national level need to be closely monitored. Strengthening the government monitoring capacity in this respect, is critical to successful project implementation.

7. Technical assistance loans (TALs) are traditionally among the weakest performers in the Bank’s portfolio. While the causes of poorly performing Bank TALs are a source of continuing debate, OED’s findings suggest that governance problems and weak management have been two main reasons for their poor past performance. The Bank’s experience with TALs in Russia underscores the importance of these lessons. In this regard, workable governance structures and strong management have been the key considerations in selecting a project implementation agency. The Foundation for Enterprise Restructuring has been selected as the PIU for the RFTAP. The FER has developed a strong project administration capacity, proven by an exemplary disbursement record and high quality of outputs. Its experience, however, highlights the need to settle the project governance arrangements and initiate procurement as early as possible in order to avoid delays in mobilization of technical assistance, which, in the case of the RFTAP, could jeopardize the government program of inter-governmental reform.

8. Fiscal adjustment and sectoral performance indicators, in particular those related to the regional structural reform of the key sectors such as housing and transport, will be developed based on the experience of various investment projects such as the EHDP. Reform programs recently developed by the IBRD under Public Resource Management Loans in Kazakhstan, Kyrgyzstan, and other FSU states will be also taken into account. Project preparation will benefit from smaller pieces of TA to regional governments in Russia, being funded under ongoing Bank projects (Community and Social Infrastructure, SPIIL and Legal Reform).
A. Project Objectives

9. The Regional Fiscal Technical Assistance Project (RFTAP) pursues the following objectives: build institutional capacity to advance the reform of inter-governmental fiscal relations, and improve fiscal performance at the sub-national level. To meet these objectives the Project sets out four sub-goals:

- improve the legal framework for sub-national public finance and inter-governmental fiscal relations;
- establish a mechanism for improving compliance with federal laws and regulations in the area of fiscal management and promote fiscally responsible behavior at the sub-national level through appropriate economic incentives;
- strengthen the Government’s capacity to monitor sub-national fiscal performance and reform efforts;
- strengthen the institutional capacity of sub-national governments to carry out fiscal and structural reforms.

10. Key policy and institutional reforms are the focus of the Project. The Project would: (i) promote the establishment of a stable, fair and predictable system of inter-governmental fiscal relations which would provide sub-national governments with appropriate incentives to undertake fiscal reforms; (ii) promote the use of modern accounting and budgeting practices which will give a fair and representative view of the financial position of sub-national governments; (iii) support the development of individual regional reform programs to reduce deficit spending and improve the efficiency of budget expenditures at the sub-national level; and (iv) improve the overall financial stability and creditworthiness of participating sub-national governments.

B. Project Description

11. The Project will finance four components: (i) Strengthening Federal and Regional Fiscal Legislation; (ii) Strengthening Federal Monitoring Capacity: Fiscal Monitoring Division and the PIU for the RFTAP; (iii) Assistance to Sub-National Governments in Accounting and Budgeting; and (iv) Sectoral Public Expenditure Reviews.

12. **Strengthening Federal and Regional Fiscal Legislation (US$2.4 million).** Development and implementation of the Government’s fiscal reform will require substantial efforts in improving the current legal framework for inter-governmental relations. Financing would be provided for local consultants and, as necessary, international experts to assist in the completion of relevant tasks. The legal and policy research efforts will be focused on high-priority themes such as inventory of the current assignment of revenue and expenditures responsibilities between the federal, regional and
local governments; design of formula-based equalization transfers for the regions; federal regulations for monitoring sub-national fiscal performance; and analysis of the consistency and compatibility of existing legislation on sub-national public finance and inter-governmental fiscal relations. It is envisaged that the work under the component will be closely coordinated with the Legal Reform Project. In addition, the component will provide for additional flexibility to respond to requests from senior officials on developments in the legal environment in the form of quick-response legal/policy notes.

13. Strengthening Federal Monitoring Capacity: Fiscal Monitoring Division and the PIU for the RFTAP (US$14.8 million). The component would finance the provision of technical assistance relating to the strengthening of institutional capacity for the design, implementation and monitoring of the fiscal and structural reforms and performance at the sub-national level, through the financing of goods and services. These expenditures would include: (i) computer and information technology needed for the statistical analysis of regional data; (ii) the creation of a library and on-line databases on regional fiscal practices and the current legislation; (iii) development and dissemination of Principles (Code) of Good Practice for regional financial management as an extra legal standard; (iv) design of financial disclosure requirements for sub-national and municipal borrowers; (v) ongoing monitoring of fiscal and structural reforms and performance at the sub-national level, as well as compliance with federal laws and regulations; (vi) analytical support and policy advice on key issues of inter-governmental fiscal reform and sub-national public finance; (vii) training, study tours for FMD staff and for government staff (including regional policy-makers) participating in the project activities to develop modern analytical skills required for the implementation of fiscal reforms; (viii) office furnishing, administrative and computer support to the staff of the FMD and consultants working on other project components.

14. The component includes a budget for conferences and seminars on inter-governmental issues to promote exchanges of experts and disseminate good fiscal management practices in the Russian regions.

15. The Project’s incremental operating costs would be financed 100% from the proceeds of the Bank loan. The MOF and regional governments would provide in-kind contributions toward the FMD’s costs (e.g., rent, utilities, senior project management, and regional support teams). Upon expiration of the Bank loan, the core activities of the FMD will be fully funded from the Government’s budget.

16. Assistance to Sub-National Governments in Accounting and Budgeting (US$10.1 million). Budgeting and fiscal management at the sub-national level in the Russian Federation, with some possible regional exceptions, has failed to keep pace with reforms at the federal level. The budget formulation process has not evolved from the previous regime’s practices. There is no modern treasury function for budget execution, ex-post audit is spotty, and there is no evaluation of budget policies. Another issue of significant importance is the lack of transparency in the regional accounting records which impairs the capacity of lenders and the federal government to make timely and adequate assessments of regional creditworthiness. The Government has initiated several major efforts to improve the quality of financial reporting and budget management in the
regions. However, these efforts have not yet spelled out in sufficient detail the changes needed in financial management, accounting and reporting at the regional level.

17. To this end, the component will finance the provision of technical assistance to the Participating Regions, in support of regional institutional development programs, consisting of: (i) diagnostic reviews and development of reform plans in the area of budgeting and fiscal management; (ii) financial planning, treasury and cash management; (iii) budgetary accounting, reporting and audit; (iv) expenditure and public sector restructuring; (v) debt management systems; (vi) regional budget procurement system; (vii) regional fiscal management guidelines, best practice standards, and regional and local public finance manual; (viii) computer equipment and design of software programs; and (ix) training of local staff needed for a successful installation and subsequent application of integrated financial management systems in the selected regions.

18. **Sectoral Public Expenditure Reviews (US$2.4 million).** Fiscal adjustment at the sub-national level is linked to the success of regional structural reforms. Current patterns of regional budget expenditures—including unsustainable subsidization—indicate that structural reforms in the regions have been slower than anticipated. The component will assist participating regions with the design of expenditure reform plans by financing a number of public expenditure reviews. These will primarily focus on the sectors which have been the largest recipients of subsidies from consolidated regional budgets such as housing and utilities, agriculture, public transportation, education and health. The reviews are expected to result in prioritization of budget expenditures into key functional sectors, identification of expenditure programs and projects with lower priority, introduction of appropriate pricing policies to provide for cost recovery, as well as identification of sectoral expenditure programs for alternative provision by the private sector. The component is expected to generate substantial savings for regional budgets in the form of reduced subsidies to the sectoral programs with low rates of return or/and of low public priority.

C. **Summary of Project Analysis**

19. **Economic.** Although the Project does not lend itself to standard cost-benefit analysis, it should improve the efficiency of public expenditure management through increased transparency in financial reporting, increased efficiency in resource allocation and improved targeting of subsidies and benefits at the sub-national level.

20. **Financial.** It has been discussed and agreed with the Government that technical assistance to the regions be provided out of the loan on a grant basis. No on-lending to the regions is envisaged.

21. **Fiscal impact.** The Project is expected to have a significant fiscal impact by promoting efficiency in public expenditure through increased transparency in budget planning and reporting. The Project would also enable regions to reduce budget deficits, reduce subsidies for housing and municipal services, and improve targeting of social assistance benefits.
22. **Technical:** It is expected that the technical assistance program will require the services of both international and local consultants in order to ensure access to international best practice, while at the same time ensuring timely access and proper interpretation of existing financial data. It is assumed that relatively limited investment will be required to develop or adapt software needed to implement new accounting and budgeting processes.

23. **Institutional:** Executing agencies: The Project will be implemented by the Foundation for Enterprise Restructuring, which will be in charge of procurement and disbursement activities. The FER staff are already experienced with Bank procedures. The conceptual guidance under the Project is to be provided by the FMD, which shall assist the GOR in designing, implementing and monitoring the inter-governmental fiscal reforms. The Inter-Ministerial Working Group for Fiscal Reform will guide the reforms and oversee the FMD’s activities. The quality monitoring function will be carried out by the Expert Council.

24. **Social:** Some expenditure reforms and, in particular, movement to cost recovery in the area of housing and communal services may adversely impact low-income groups. Consideration will be given to improvement of targeting of assistance to the poorest groups. The project will incorporate the lessons of economic and sector work already undertaken in this area, including the experience of the SPIL.

25. **Environmental assessment:** For the purposes of environmental assessment, the Project falls into Category C.

**D. Project Benefits**

26. The principal project benefit will be the improved legal framework of sub-national public finance and inter-governmental fiscal relations and structural adjustment at the sub-national level. These would result from intensive project efforts to enhance the existing legal framework of inter-governmental relations and improve institutional capacity of the federal government and the regions in fiscal and economic management. As a result of the Project, the Government is expected to retain enhanced capacity in government institutions for analytic economic work and monitoring in the area of inter-governmental fiscal relations. A principal benefit of the Project in the long term will be sounder fiscal and economic policies of the regions.

**E. Project Risks**

27. There is a risk that the current consensus in favor of inter-governmental fiscal reform might be lost and that the program might then stall. This risk is partially mitigated by including representatives of the Duma and the Federation Council in the IMWG. The reason that progress toward a more stable and transparent inter-governmental fiscal system is important for the success of this project is that without consistent and positive incentives in support of regional fiscal reform, technical assistance might not lead to a change in behavior. The federal dimensions of the project, in particular, are designed to mitigate this risk.
28. The possible weakening of political will to implement fiscal management reforms at the regional level poses another risk for the Project. This could happen as a result of the improved transparency of regional budgets and accounting procedures imposing hard budgetary constraints on the regional administrations, thus making it difficult to resort to off-budgetary funds or to accrue off-budgetary liabilities. Such a situation could trigger political opposition to the Project at the sub-national level. Maintaining positive regional perceptions of the benefits of inter-governmental fiscal reform can mitigate this risk by rewarding those who undertake agreed reforms.
RUSSIAN FEDERATION
REGIONAL FISCAL TECHNICAL ASSISTANCE PROJECT

III. PROJECT COST, FINANCING, MANAGEMENT AND IMPLEMENTATION

A. Project Costs

29. The total project cost is estimated at US$36.2 million, including contingencies amounting to US$2.0 million, taxes of US$4.7 million, and an up-front fee of US$0.3 million. The Bank would finance US$30.0 million or approximately 83% of total project costs. The estimated project cost summaries are shown in Tables 3.1 and 3.2. All project costs are based on August 1999 prices. FMD and FER incremental staff costs were estimated based upon current rates for local staff operating in the Foundation for Enterprise Restructuring (FER) in Moscow, adjusted for current labor market conditions in Russia.

30. Project costs include technical assistance (consulting services), training, operating expenses of the Fiscal Monitoring Division and the PIU (Foundation for Enterprise Restructuring), cost of goods, contingencies, and the commitment fee (1% of the loan amount):

- **Technical Assistance (TA) (US$21.5 million).** TA costs were derived from terms of reference and recent fees quoted for comparable specialized services in Bank-financed projects in Russia. Both foreign and local consultants will be responsible for any tax liability incurred in the course of the Project. Most of the research and analysis conducted by the FMD will be carried out with the assistance of local consultants contracted on both short- and long-term bases. The estimated cost for local consultants is US$3,000 per person-month. Foreign TA will be needed to guide FMD staff and local consultants in internationally-recognized analytical techniques in selected policy areas. The estimated cost for foreign consultants is US$20,000 per person-month.

- **Operating Costs (US$6.8 million).** The Bank would finance a part of the US$5.4 million Fiscal Monitoring Division operating costs. Bank financing of the FMD would amount to US$3.9 million. The Bank would also finance operating costs of the Foundation for Enterprise Restructuring in the amount of US$1.4 million.

- **Goods (US$1.9 million).** Unit costs were based on similar goods recently purchased in Russia from local suppliers.
Table 3.1
Estimated Project Costs
(US$ equivalent)

<table>
<thead>
<tr>
<th></th>
<th>Foreign</th>
<th>Local</th>
<th>Total</th>
<th>Foreign as % of Total</th>
<th>Component Cost as % of Total Cost</th>
</tr>
</thead>
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<tr>
<td><strong>A. TECHNICAL ASSISTANCE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project Component 1. Strengthening Federal Legislation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>1.1. technical assistance</td>
<td>1,962,000</td>
<td>218,000</td>
<td>2,180,000</td>
<td>90%</td>
<td>6%</td>
</tr>
<tr>
<td>Project Component 2. Strengthening Federal Monitoring Capacity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1. technical assistance</td>
<td>6,670,800</td>
<td>654,000</td>
<td>7,324,800</td>
<td>91%</td>
<td>20%</td>
</tr>
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<td>Project Component 3. Assistance to Sub-National Governments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 technical assistance</td>
<td>5,668,000</td>
<td>2,180,000</td>
<td>7,848,000</td>
<td>72%</td>
<td>22%</td>
</tr>
<tr>
<td>Project Component 4. Sectoral Public Expenditure Reviews</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.1 technical assistance</td>
<td>0</td>
<td>2,180,000</td>
<td>2,180,000</td>
<td>0%</td>
<td>6%</td>
</tr>
<tr>
<td><strong>Total Technical Assistance</strong></td>
<td>14,300,800</td>
<td>5,232,000</td>
<td>19,532,800</td>
<td>73%</td>
<td></td>
</tr>
<tr>
<td><strong>B. OPERATING EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiscal Monitoring Division Operating Costs</td>
<td>0</td>
<td>5,446,300</td>
<td>5,446,300</td>
<td>0%</td>
<td>15%</td>
</tr>
<tr>
<td>PMU Operating Costs</td>
<td>0</td>
<td>1,389,500</td>
<td>1,389,500</td>
<td>0%</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>0</td>
<td>6,835,800</td>
<td>6,835,800</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td><strong>C. GOODS</strong></td>
<td>1,800,000</td>
<td>480,000</td>
<td>2,280,000</td>
<td>79%</td>
<td>6%</td>
</tr>
<tr>
<td><strong>D. PRICE CONTINGENCIES</strong></td>
<td>1,430,080</td>
<td>1,501,320</td>
<td>2,931,400</td>
<td>49%</td>
<td>8%</td>
</tr>
<tr>
<td><strong>E. VAT on SERVICES</strong></td>
<td>3,146,176</td>
<td>1,151,040</td>
<td>4,297,216</td>
<td>73%</td>
<td>12%</td>
</tr>
<tr>
<td><strong>F. FEE (1% of the Loan)</strong></td>
<td>0</td>
<td>300,000</td>
<td>300,000</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td><strong>TOTAL PROJECT COST</strong></td>
<td>20,677,056</td>
<td>15,500,160</td>
<td>36,177,216</td>
<td>57%</td>
<td>100%</td>
</tr>
</tbody>
</table>
### Table 3.2
**Project Financing Plan**
**US$, including taxes**

<table>
<thead>
<tr>
<th></th>
<th>Foreign</th>
<th>Local</th>
<th>Total</th>
<th>Foreign as % of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>GOR</td>
<td>0</td>
<td>6,177,216</td>
<td>6,177,216</td>
<td>0%</td>
</tr>
<tr>
<td>World Bank</td>
<td>16,100,800</td>
<td>10,667,800</td>
<td>26,768,600</td>
<td>60%</td>
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<tr>
<td>Contingencies</td>
<td>1,430,080</td>
<td>1,501,320</td>
<td>2,931,400</td>
<td>49%</td>
</tr>
<tr>
<td>Fee (1% of the Loan)</td>
<td>0</td>
<td>300,000</td>
<td>300,000</td>
<td>0%</td>
</tr>
<tr>
<td>Total</td>
<td>17,530,880</td>
<td>18,646,336</td>
<td>36,177,216</td>
<td>48%</td>
</tr>
<tr>
<td>% of Total</td>
<td>48%</td>
<td>52%</td>
<td>100%</td>
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</tr>
</tbody>
</table>

**B. The Borrower’s Financial Contribution**

31. Total Government financing would be US$6.2 million. This amount would be comprised of in-kind contributions toward the FMD’s recurrent costs (see Table 3.3 for details), as well as 100% of any taxes/duties on goods and VAT on consultant services. Expenses eligible for financing under this arrangement would include: staff salaries, rent, travel, and utilities.

- **US$1.5 million of the FMD’s operating expenses.** The FMD’s operating costs amount to US$5.4 million, of which the Borrower would be responsible for covering US$1.5 million. The Borrower’s portion would be comprised of in-kind contributions spread over the life of the Project (see Tables 3.3 and 3.4).

- **Taxes and duties levied on Goods (US$0.4 million).** The Borrower would be responsible for covering all taxes and duties levied on Goods.

- **Taxes (VAT) on Consultant Services (US$4.3 million).** The Borrower would be responsible for covering all VAT charges levied on Consultant Services.
Table 3.3
Value of Government’s In-Kind Contribution
(US$ equivalent)

<table>
<thead>
<tr>
<th></th>
<th>per year</th>
<th>over 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Central Office:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff</td>
<td>113,520</td>
<td>567,600</td>
</tr>
<tr>
<td>Rent</td>
<td>40,800</td>
<td>204,000</td>
</tr>
<tr>
<td>Travel</td>
<td>700</td>
<td>3,500</td>
</tr>
<tr>
<td>Utilities</td>
<td>3,400</td>
<td>17,000</td>
</tr>
<tr>
<td>2. Regional Offices:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff</td>
<td>134,640</td>
<td>673,200</td>
</tr>
<tr>
<td>Rent</td>
<td>14,400</td>
<td>72,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>307,460</td>
<td>1,537,300</td>
</tr>
</tbody>
</table>

Table 3.4
Proposed Schedule of Government Staffing under the Project
(man months)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regional Government Contribution</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional Support Teams</td>
<td>108</td>
<td>108</td>
<td>108</td>
<td>108</td>
<td>108</td>
<td>540</td>
</tr>
<tr>
<td>MOF Contribution to Moscow</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FMD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Division Head</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>60</td>
</tr>
<tr>
<td>Deputy Division Head</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>60</td>
</tr>
<tr>
<td>Consultants</td>
<td>12</td>
<td>24</td>
<td>36</td>
<td>48</td>
<td>48</td>
<td>168</td>
</tr>
<tr>
<td>Chief Specialist</td>
<td>24</td>
<td>24</td>
<td>24</td>
<td>24</td>
<td>24</td>
<td>120</td>
</tr>
<tr>
<td>Leading Specialist</td>
<td>12</td>
<td>24</td>
<td>24</td>
<td>24</td>
<td>24</td>
<td>108</td>
</tr>
<tr>
<td>Sub-Total</td>
<td>72</td>
<td>96</td>
<td>108</td>
<td>120</td>
<td>120</td>
<td>516</td>
</tr>
<tr>
<td>Total Man-Months</td>
<td>180</td>
<td>204</td>
<td>216</td>
<td>228</td>
<td>228</td>
<td>1,056</td>
</tr>
</tbody>
</table>

C. Procurement

32. All Bank-financed goods and consultant services would be procured in accordance with the Bank’s Guidelines: Procurement Under IBRD Loans and IDA Credits (January 1995, revised January and August 1996, September 1997, and January 1999) and Guidelines: Selection and Employment of Consultants by World Bank Borrowers (January 1997, revised September 1997 and January 1999), respectively. National Shopping (NSH) procurement would require that original price quotations and receipts from suppliers be kept on file for review/audit purposes during supervision missions. The FER’s Administrative Department would be responsible for tracking procurement actions and approvals as well as periodically reporting to the Bank on procurement progress.
Two additional procurement staff will be hired to work in the PIU, including one Senior Procurement Specialist, and one Associate Procurement Specialist. Also, staff will be trained through periodic training workshops conducted by the Bank.

- **General Procurement.** The majority of procurement actions under the proposed project would be for consultant services. To ensure that the standard of consultants procured under the Project were of sufficiently high quality, the FER would submit for the Bank’s prior review terms of reference for all consultant contracts. Advertisements would be placed in Development Business, and expressions of interest from firms sought for all ICB and consultant contracts. UNDB publications will be updated annually. Tables in Annex 2 list the applicable method of procurement for each goods or consultant services package.

- **Goods.** An estimated US$1.9 million worth of goods would be procured, including office supplies, furniture and equipment for the FER and FMD, and computers for the participating regions. All office supplies, furniture and equipment would be purchased using the National Shopping (NSH) procurement method, grouped in packages not to exceed US$50,000 (US$550,000 total). As such, none of the packages would require prior Bank approval. To minimize the number of contracts and reduce the unit costs, computers for the regions would be purchased in packages of about US$700,000 each (US$1.5 million total). These packages would be procured using the ICB method and require prior Bank approval.

- **Technical Assistance/Consulting Services.** Approximately US$21.5 million in consultant services contracts would be procured to provide technical assistance in the form of specialists/advisers, studies, training programs, seminars and workshops. These items would be covered under four primary components (i.e., Strengthening Federal Legislation; Strengthening Federal Monitoring Capacity; Assistance to Sub-National Governments in Regional Fiscal Reform; and Sectoral Public Expenditure Reviews).

- **Operating Costs.** These costs, in the amount of US$6.8 million, include incremental operating costs of the FER and FMD related to Project implementation and will be based on annual budgets approved by the Bank. The staff will be employed in accordance with Bank Consultant Guidelines and should be experienced, capable, and their terms and conditions of employment acceptable to the Bank and subject to prior review.
## Table 3.5: Summary of Proposed Procurement Arrangements
(US$ million equivalent)

<table>
<thead>
<tr>
<th>Project Element</th>
<th>Procurement Method</th>
<th>ICB</th>
<th>NCB</th>
<th>Other</th>
<th>N.B.F.</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Works</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Goods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Equipment,</td>
<td>1.8</td>
<td>0.5</td>
<td></td>
<td></td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td>Computers, Printers</td>
<td>(1.5)</td>
<td>(0.4)</td>
<td></td>
<td></td>
<td>(1.9)</td>
<td></td>
</tr>
<tr>
<td>3. Consultancies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>25.8</td>
<td></td>
<td></td>
<td></td>
<td>25.8</td>
<td></td>
</tr>
<tr>
<td>4. Incremental Operating Costs</td>
<td>6.8</td>
<td></td>
<td></td>
<td></td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>5. Unallocated</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Front-End Fee</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1.8</td>
<td></td>
<td></td>
<td>34.4</td>
<td>36.2</td>
</tr>
<tr>
<td>Total Bank Financed</td>
<td>(1.5)</td>
<td>(28.5)</td>
<td></td>
<td></td>
<td>(30.0)</td>
<td></td>
</tr>
</tbody>
</table>

Note: Figures in parenthesis are the respective amounts to be financed by the Bank loan.

### D. Disbursements

33. The loan is expected to be fully disbursed over 5 years, closing on December 31, 2004. The Bank would finance: (i) 100% of expenditures for consultant services; (ii) 100% of expenditures for training, seminars/workshops and study tours; (iii) 100% of foreign expenditures, 100% of local expenditures (ex-factory cost), and 80% of local expenditures for other items procured locally; and (iv) 100% of recurrent costs of the FMD and FER (minus staff, rent, travel and utilities costs covered by the Borrower as in-kind contributions).

34. Special Account. To facilitate timely project implementation, the Borrower would establish, maintain and operate, under conditions acceptable to the Bank, a Special Account in US dollars in a commercial bank in Russia. It is envisaged that the FER would perform the duties assigned to a PIU, including the procurement of consultant services and disbursement of loan funds and coordination of project activities. The Special Account would finance operation of the Foundation for Enterprise Restructuring and the FMD. In the initial phase of the Project, the balance for the Special Account would be limited to US$500,000. However, when the aggregate amount disbursed under the loan reached US$3.0 million, the initial allocation would be increased up to the authorized allocation of US$1.0 million by submitting the relevant Application for Withdrawal. Replenishment applications would be submitted at least every three months, and would include reconciled bank statements, as well as other appropriate supporting documents.
35. Disbursements based on Statements of Expenditure (SOEs) would be used for: (i) consulting firms below US$100,000 equivalent (including studies and training); and (ii) conferences, workshops and seminars. Documentation supporting the SOEs would be retained by the FER and FMD and made available for review by the Bank supervision missions and auditors.

36. **Accounts and Audits**. The FER will maintain a single set of project accounts, including the account of the FMD and the Special Account. An audit of the accounts will be performed annually in accordance with standards acceptable to the Bank. All projects implemented by the FER shall be audited as a single entity: the RFTAP will be included among these projects. Once the annual audit has been performed, it will be submitted to the Bank by the FER within six months of the end of the Government’s fiscal year. For further details, see the Financial Capacity Assessment Report (Annex 6).

### Table 3.6

**Estimated Loan Disbursement Schedule**

<table>
<thead>
<tr>
<th>Bank Fiscal Year</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Semester</td>
<td>Jan 00 - Jun 00</td>
<td>Jul 00 - Dec 00</td>
<td>Jan 01 - Jun 01</td>
<td>Jul 01 - Dec 01</td>
<td>Jan 02 - Jun 02</td>
<td>Jul 02 - Dec 02</td>
</tr>
<tr>
<td>Per Semester (%)</td>
<td>4%</td>
<td>4%</td>
<td>14%</td>
<td>15%</td>
<td>22%</td>
<td>24%</td>
</tr>
<tr>
<td>Per Semester ($)</td>
<td>1.2</td>
<td>1.2</td>
<td>4.2</td>
<td>4.5</td>
<td>6.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Cumulative (%)</td>
<td>4%</td>
<td>8%</td>
<td>22%</td>
<td>37%</td>
<td>59%</td>
<td>83%</td>
</tr>
<tr>
<td>Cumulative ($)</td>
<td>1.2</td>
<td>2.4</td>
<td>6.6</td>
<td>11.1</td>
<td>17.7</td>
<td>24.9</td>
</tr>
</tbody>
</table>

### Table 3.7

**Disbursements by Category**

**World Bank Financing**

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount (US$)</th>
<th>Percentage of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Goods</td>
<td>1,900,000</td>
<td>100% of foreign expenditures, 100% of local expenditures (ex-factory cost), and 80% of local expenditures for other items procured locally</td>
</tr>
<tr>
<td>2. Consultants' Services</td>
<td>21,500,000</td>
<td>100%</td>
</tr>
<tr>
<td>3. Incremental Operating Costs</td>
<td>5,300,000</td>
<td>100%</td>
</tr>
<tr>
<td>4. Unallocated</td>
<td>1,000,000</td>
<td></td>
</tr>
<tr>
<td>5. Fee</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>30,000,000</td>
<td></td>
</tr>
</tbody>
</table>
E. Project Implementation: Management Structure

37. **Overall Project Management Structure** - The Government of the Russian Federation has created the Inter-Ministerial Working Group (IMWG) to represent its interests for the purposes of this project. It is the intention of the IMWG to build capacity in the Ministry of Finance (MOF) both to monitor regional fiscal performance and to design and guide the implementation of policies and regulations in this sphere. The IMWG has decided to implement the Project through a special unit based in the MOF, known as the **Fiscal Monitoring Division** (FMD), which shall provide substantive leadership for this project and for the Government’s relations with the World Bank on regional fiscal policy and to act as its secretariat. In order to assist with project implementation, the MOF has created a special division on monitoring of regional finance in its Department of Inter-Budgetary Relations. The Head of this division, who is also the Deputy Department Head in the MOF, will act as the Project Director and Head of the FMD. The IMWG has also designated the **Foundation for Enterprise Restructuring and Financial Institutions Development** (FER) to assist project implementation with administrative, procurement, accounting and other procedural support. A discussion of the key elements of the project management structure follows (see also Project Organizational Chart).

38. **The Inter-Ministerial Working Group** - The IMWG is composed of representatives of key government agencies involved in designing and implementing inter-governmental fiscal reforms such as the Ministry of Finance (MOF), Ministry of Regional Policy, Ministry of Economy, Apparatus of the President, the Working Center for Economic Reforms, and the Bureau of Economic Analysis, and has the decision-making powers commensurate with the task of carrying out inter-governmental and regional fiscal reform in the Russian Federation. The IMWG establishment is part of the overall Government concept of inter-budgetary relations reform. The First Deputy Chairman of the Government chairs the Group. The key functions of the IMWG are: (i) strategic management of the Project; (ii) coordination of Project activities with other Government efforts in this area; (iii) approval of draft decrees and resolutions prepared under the Project and their submission to the Government; (iv) coordination of efforts between federal and regional authorities; and (v) overall supervision of the FMD and FER performance under the Project. In order to implement these functions, the IMWG approves the annual work plans and budgets for the Project, approves the key Project documents, approves the regions for participation in the Project, oversees the core activities of the FMD, approves the main TOR and consultant reports, approves the evaluation committees for the Project, and approves the Project Director.

39. **Fiscal Monitoring Division** - The main objective of the FMD is implementation and monitoring of the reform of the inter-governmental fiscal relations at the national and regional level. Under the Project, the FMD would be responsible for the design of the monitoring system to be further supported by the MOF after the Project’s completion. It will also be responsible for the supervision and coordination of Project activities on all components. The FMD will act as a designated agent of the IMWG in carrying out Project activities.
40. The FMD's tasks and Project-related activities would be directly linked to the MOF's fiscal reform agenda, which would be ensured by the MOF's representation in the IMWG and contribution of MOF staff to the FMD. MOF would instruct regional finance departments and the regional administrations to provide the FMD with fiscal data necessary for its analytical work. The FMD would prepare annual budget estimates for project-related activities (tasks) and submit them to the IMWG for approval.

41. The Head of the FMD (Project Director) is the head of the monitoring division of the MOF and has been appointed by the IMWG. The FMD staff consists of the staff of the monitoring division of the MOF, to be supplemented by consultants hired through the Project. The MOF will initially contribute 5 staff members to the FMD, with this number to increase over the life of the project to 10 in the year 2004. After project completion the MOF is expected to be able to perform the monitoring functions of the FMD using only the staff of its monitoring division and the staff hired by the regions.

42. The staff of the FMD will report to the FMD Head on all substantive issues of project implementation. Hiring of all consultants for the FMD will be subject to World Bank procurement rules for the selection of individuals. At least three (3) candidates will be reviewed for each position. Once the appropriate candidate is identified, the FER will issue a contract to the selected individual. All contracts would be signed for no longer than one (1) year and could be renewed upon the request of the FMD Head, subject to satisfactory performance of the consultant.

43. The FMD staffing plan is as follows (see also FMD Organizational Chart):

The **FMD Head** is a public servant reporting to the IMWG. He has been appointed and released from his regular duties by the Minister of Finance, as approved by the IMWG. He is also the Head of the Monitoring Division of the MOF and therefore will have direct authority over the MOF staff in the FMD. The FMD Head will be in charge of all conceptual and analytical work within the Project, as well as building and maintaining government fiscal monitoring capacity in the MOF and in the regions. In particular, the FMD Head will perform the following tasks:

- provide conceptual guidance and supervise all project related tasks;
- design and manage the capacity within the FMD to perform the statistical analysis of regional data;
- create computer linkages with the Ministry of Finance and the regions, establish a library and on-line databases on regional fiscal practices and the current legislation for analytical work of the FMD itself, for the regional policy-makers, for investors and for the general public;
- manage monitoring of regional compliance with federal laws and regulations as well as with the RFRP regional conditionalities;
- provide analytical support and policy advice to the government on key issues of inter-governmental reform;
- organize publication and dissemination of Good Practice standards for regional finance managers.
The major part of the FMD staff would work under the Strengthening Federal Monitoring and Capacity Component that is the major part of the project. Two Senior Experts would assist the FMD Head in this work. The **Senior Fiscal Analyst** would coordinate the work of five (5) regional fiscal analysts financed from the loan and four (4) MOF-financed specialists. The number of WB financed specialists would decrease to two (2) in the third year of project implementation and to one (1) in the fourth year. This reduction would be substituted by the increase of the MOF-financed specialists to five (5) in year two of the project, seven (7) in year three, and eight (8) in year four, at which stage they should be able to work with the monitoring system designed under the Project without external assistance. The major functions of the analytical group include:

- organization of regional financial reviews in order to select the regions eligible for borrowing under the RFRP and other World Bank lending programs;
- establishment of the information system needed for the statistical analysis of regional data and computer linkages with the Ministry of Finance and the regions.

44. The **Senior Expert on Coordination with the Regions** would be responsible for all activities of the Project at the sub-national level. He/she would be assisted by the regional support teams (initially six (6) teams with three (3) persons in each team working during the first three years of the project) and regional representatives (working during the last three years of the project in all regions). The major work of this group would be related to coordination of all project activities in the regions, including the public expenditure reviews and technical assistance to the regional governments. In addition, he/she will be responsible for:

- providing technical assistance to sub-national governments in budgeting and financial reporting, accounting, expenditure management, and debt management;
- assisting the FMD in development of the database on regional fiscal practices and the current legislation to meet the research needs of the FMD and the MOF;
- developing a Code of Good Practice for regional financial management as an extra-legal standard; and
- establishing relevant status and incentives/sanctions for compliance/non-compliance with federal laws and regulations as well as with the RFRP regional conditionalities.

45. The work of consultants under the Monitoring Component would be supervised by the FMD Head, assisted by the Senior Fiscal Analyst and the Senior Expert on Coordination with the Regions. They will be responsible for the preparation of the TORs and the tenders, initial selection of project contractors, evaluation of technical proposals, and approval of results of Consultants' work. The FMD Head would determine the detailed division of work between the two Senior Specialists.

46. All other **Component Managers (Senior Coordinators)** will report to the FMD Head on substantive matters. They will be responsible for the preparation of TORs, initial selection of project contractors, evaluation of technical proposals, approval of results of Consultants' work, and coordination with the World Bank, the IMWG, and the Expert Council. All component managers would work till the end of the project, except for the **Senior Coordinator of the Public Expenditure Review Component**.
47. The Senior Coordinator of the Regional Technical Assistance Component would be assisted by one expert. They would provide technical and analytical support in the implementation of this project component. The Senior Coordinator of the Legislative Component would supervise legal research, coordinate activities of the legal component with developments under the World Bank Legal Reform Project, and organize quick policy/legal expert reviews and consultations upon request from the IWMG. The Legal Expert would support him/her. The Senior Coordinator of the Public Expenditure Reviews would manage the Public Expenditure Review Component of the Project. This specialist would organize the regional fiscal reviews to determine the overall fiscal health of the regions and identify potential areas for improvements.

48. Project Implementation Unit (PIU). The Non-Commercial Foundation for Enterprise Restructuring and Financial Institutions Development (FER) would be responsible for compliance with all World Bank procedures, including the procurement, financial management, accounting, reporting and audits. The FER would provide similar support to the MOF in implementation of contracts under all project components. The FER would report to the IMWG, which would assume the functions of the FER Project Management committee (such committees are envisaged by the FER Charter for all its projects).

49. The Director General, supported by two Deputy Director Generals, leads the FER's management team. The FER's functional organization is divided into two types of budgetary groups: general services and project groups. General services consist of the following departments: management, secretariat, contract, finance and accounting. General services are responsible for procurement, disbursement, and financial management and contract management. Costs of the general services departments are allocated to operating costs categories of all projects in proportion, reviewed and agreed by the PMC and approved by the Board. It is envisaged that approximately 15% of the general services department costs would be allocated to the RFTAP project annually (this is equivalent of approximately three full-time professionals and two full-time support staff).

50. The Contract Management Department handles all issues of procurement, contract monitoring and legal support. Staff of the Department consist of the following: Manager of the Procurement Department/Senior Legal Counsel, Senior Procurement Officer, Procurement Specialist/Legal Counsel and Assistant. The Manager of the Department reports to the Deputy Director. Due to the increased workload of the contract management department related to new projects, it is expected that at least two (2) additional Procurement Specialists would be hired by the FER. Specific staff of the Contract Management department would be appointed to be responsible for the RFTAP contracts. They would be assisted, if necessary, by other staff of the Contract Management Department.

51. The Finance Department is headed by the Director of Finance, supported by three staff: a Disbursement Specialist, a Junior Disbursement Specialist, and a Specialist on Sub-Loan Management. The Director of the Finance Department reports to the Deputy Director General. Included within the responsibilities of the Finance Department are the preparation of project financial management reports in conformity with Bank
requirements, as well as monthly reporting to the Ministry of Finance. Due to the increased workload of the Contract Management Department related to the new projects, it is expected that at least one (1) additional Financial Analyst would be hired by the FER. A new integrated project accounting and reporting system would be developed by the FER, in order to comply with LACI requirements. This system would significantly reduce the workload of the finance department. Specific staff of the Finance Department would be appointed to be responsible for RFTAP contracts. They would be assisted, if necessary, by other staff of the Finance Department.

52. The **Accounting Department** is headed by Chief Accountant, who is supported by two permanent Staff Accountants and one full-time Consultant. The Chief Accountant reports directly to the Director General. The Accounting Department is responsible for producing financial statements in compliance with Russian law and International Accounting Standards, as well as for ensuring compliance with current tax law. Due to the introduction of the new project accounting system, no cost increases are envisaged in the accounting department.

53. **Expert Council (EC).** The EC provides quality oversight of the FMD's work. Also, upon the Head of the FMD's request, it will review project outputs such as: terms of reference, draft laws, regulations, and policy studies. Once a year it will prepare quality review reports and submit them to the IMWG and the Project Director. It will report to the IMWG. In addition, the Expert Council would perform a general advisory role in support of IWMG and FMD operations and Project implementation functions.

54. The Expert Council would consist of three members—one (1) international expert, and two (2) Russian experts. In the absence of FMD Head, the EC's clearance will be required for any Project deliverable to be presented to the FER for payment. EC members would be appointed to and released from their duties by the IMWG, as well as report to the IMWG.

55. **Procurement and Disbursement under the Project.** The Project procurement and disbursement process is illustrated in the following Organizational Charts. Contractors for specific Project-related tasks would be hired on a competitive basis only, including individual consultants to be hired by the FER in support of the FMD's operations. The Project Tender Commission would be responsible for the final selection of contractors for all project tasks. The Tender Commission would include representatives from the key government agencies involved in project implementation including: Ministry of Finance, Ministry of Economy, Ministry of Regional Policy, and the FER. To proceed with the final selection of contractors, the TOR for each project task would be prepared by the FMD on the basis of the annual Project work program. The annual work program would be cleared by the IMWG and by the World Bank and would be consistent with the overall Project Implementation Plan specified in the loan documents, including the Project Appraisal Report.

56. Upon receiving a project deliverable for a specific Project task, a Line Manager of a Project Component would perform its initial evaluation, and, if satisfied, would submit it for clearance to the FMD Head, or in his absence to the EC. The FMD would approve the report and submit an invoice for payment by the FER. In certain cases. World Bank
"no objection" letters and clearances from the IMWG would be required as well. The FER's Finance and Accounting Departments will process the application in accordance with internal review procedures, check the compliance of the invoice and the supporting documents with the Consultants' contract provisions and WB requirements and would then make payment to the contractor. It is expected that if no major deficiencies are identified in the invoice and supporting documents an FER internal review would be performed and invoice submitted for payments within five (5) working days of receipt of the approved report from the FMD.

57. **Production of TORs.** This process is the same as the process of the Projects Outcomes Delivery, with one exception: the IMWG's clearance is required for TORs related to legal policy design in inter-governmental reform.
Regional Fiscal Technical Assistance Project
Fiscal Monitoring Division
Organizational Chart
ANNEX 1

PERFORMANCE AND MONITORING INDICATORS
<table>
<thead>
<tr>
<th>Project development objectives</th>
<th>Goals</th>
<th>Actions</th>
<th>Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved intergovernmental fiscal relations</td>
<td>Stable, fair and predictable system of intergovernmental fiscal relations</td>
<td>Strengthen federal monitoring capacity</td>
<td>Computerized information network for fiscal monitoring in place</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Inventory expenditure assignments among various levels of government</td>
<td>Inventories of expenditure assignments completed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Clarify expenditure assignments among various levels of government</td>
<td>Laws and legal amendments on expenditure assignments drafted</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Phase out unfunded mandates</td>
<td>Laws and legal amendments on unfunded mandates drafted</td>
</tr>
<tr>
<td>Improved fiscal performance at the regional and municipal level</td>
<td>Modern accounting and budgeting</td>
<td>Implement Treasury principles of budget execution</td>
<td>Treasury principles of budget execution implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Adopt a Code of Good Practice of regional fiscal management</td>
<td>Regional compliance with clauses of Code of Good Practice improved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Prepare model draft laws on reporting, budgeting and budget management</td>
<td>Laws on reporting, budgeting and budget management drafted</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Install computerized information network for decision-making and reporting purposes</td>
<td>Computerized systems, in particular financial reporting, installed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Prepare model draft laws on capital and multi-year budgeting</td>
<td>Model laws on capital and multi-year budgeting drafted</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Prepare model draft laws on budget audits</td>
<td>Model laws on budget audits drafted</td>
</tr>
<tr>
<td>Modern debt management</td>
<td></td>
<td>Adopt a system for debt management</td>
<td>Regional borrowing and debt servicing profiles improved</td>
</tr>
<tr>
<td>Stable, fair and predictable system of intra-governmental fiscal relations</td>
<td>Design formula-based equalization transfers</td>
<td>Formula-based equalization transfers designed</td>
<td></td>
</tr>
</tbody>
</table>
ANNEX 2

PROCUREMENT PLAN
1. Thresholds for Procurement Methods and Prior Review
Russian Federation: Regional Fiscal Technical Assistance Project

<table>
<thead>
<tr>
<th>Section 1: Procurement Review</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Category</strong></td>
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<tr>
<td>-----------------</td>
</tr>
<tr>
<td><strong>Civil Works</strong></td>
</tr>
<tr>
<td>1.1. Procurement Thresholds</td>
</tr>
<tr>
<td>1.2. Prior Review</td>
</tr>
<tr>
<td><strong>Goods</strong></td>
</tr>
<tr>
<td>2.1 Procurement Thresholds:</td>
</tr>
<tr>
<td>2.2. Prior Review</td>
</tr>
<tr>
<td><strong>Consultant Services</strong></td>
</tr>
<tr>
<td>3.1. Aggregate Amounts</td>
</tr>
<tr>
<td>3.2. Prior Review</td>
</tr>
</tbody>
</table>

Ex-Post Review: Ex-post review will be required of Consultant contracts below the threshold, plus Goods purchased under NSH.

Section 2. Capacity of the Implementing Agency in Procurement and Technical Assistance requirements

5. Brief statement: The Contracts Management Department of FER has at present four staff (3 Specialists and 1 Assistant) and is planning to recruit two more Procurement Specialists to increase capacity. The new staff will not be assigned specifically to the new project, but will take their share of the overall workload in accordance with a clear distribution of responsibilities within the Department.


Section 3. Training, Information and Development on Procurement


15. Brief description of the Procurement Monitoring System and Information System: The Foundation for Enterprise Restructuring (FER) will maintain complete procurement files, which will be reviewed by the Bank’s supervision missions. The Procurement Plan will be updated regularly. Procurement information will be recorded by the FER and submitted to the Bank as part of the quarterly and annual progress reports. This information will include: revised cost estimates for the different contracts; revised timing of procurement actions, including advertising, bidding, contract award, status of contracts, and completion time for individual contracts, and compliance on specific methods of procurement. A Management Information System (MIS), with a procurement module, will help the FER monitor all procurement information.

16. Name of Procurement Staff Member on the Project Team: Karl Skansing, Moscow RM Division: ECCRU Tel. 7-095-745-7000 (ext. 2073) | 17. Brief description of the role expected of the Field Office in Procurement: The Moscow RM will provide procurement review and back-up to the Project team. |
### 2. Procurement Schedule
Russian Federation: Regional Fiscal Technical Assistance Project

<table>
<thead>
<tr>
<th>Component</th>
<th>Type</th>
<th>Contract No.</th>
<th>Procurement Method</th>
<th>Doc's Submitted to Bank</th>
<th>Invitation to Bid</th>
<th>Contract Signing</th>
<th>Contract Completion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. CIVIL WORKS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>B. GOODS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Office Equipment/Supplies</td>
<td>Goods</td>
<td>01-08/G</td>
<td>NSH</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2. Computers/Printers - Regions</td>
<td>&quot;</td>
<td>09-11/G</td>
<td>ICB</td>
<td>Jan-01</td>
<td>Apr-01</td>
<td>Jul-01</td>
<td>Dec-03</td>
</tr>
<tr>
<td><strong>C. SERVICES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Strengthen Federal Legislation</td>
<td>Consultant</td>
<td>RF/CS/1.1</td>
<td>QCBS</td>
<td>Feb-00</td>
<td>Apr-00</td>
<td>Nov-00</td>
<td>Jun-04</td>
</tr>
<tr>
<td>1.01 Inter-governmental fiscal relations, regional budgeting and debt management</td>
<td>&quot;</td>
<td>RF/CS/1.2</td>
<td>QCBS</td>
<td>Feb-00</td>
<td>Mar-00</td>
<td>Jul-00</td>
<td>Apr-02</td>
</tr>
<tr>
<td>1.02 Regional development fund</td>
<td>&quot;</td>
<td>RF/CS/1.3</td>
<td>QCBS</td>
<td>Feb-00</td>
<td>May-00</td>
<td>Nov-00</td>
<td>Apr-03</td>
</tr>
<tr>
<td>2. Strengthening Federal Monitoring Capacity</td>
<td>Consultant</td>
<td>RF/CS/2.1</td>
<td>QCBS</td>
<td>Jan-01</td>
<td>Mar-01</td>
<td>Oct-01</td>
<td>Jun-04</td>
</tr>
<tr>
<td>2.01 “Standard” monitoring system</td>
<td>&quot;</td>
<td>RF/CS/2.2</td>
<td>QCBS</td>
<td>Mar-00</td>
<td>May-00</td>
<td>Dec-00</td>
<td>Jun-04</td>
</tr>
<tr>
<td>2.02 “Extended” and “special” monitoring ratings</td>
<td>&quot;</td>
<td>RF/CS/2.3</td>
<td>QCBS</td>
<td>Mar-00</td>
<td>May-00</td>
<td>Nov-00</td>
<td>Apr-03</td>
</tr>
<tr>
<td>2.03 Fiscal statistic database development</td>
<td>&quot;</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Assistance to Sub-National Governments</td>
<td>Consultant</td>
<td>RF/CS/3.1</td>
<td>QCBS</td>
<td>Mar-00</td>
<td>May-00</td>
<td>Dec-00</td>
<td>Sep-03</td>
</tr>
<tr>
<td>3.01 Financial planning, treasury and cash management</td>
<td>&quot;</td>
<td>RF/CS/3.2</td>
<td>QCBS</td>
<td>Mar-00</td>
<td>May-00</td>
<td>Dec-00</td>
<td>Sep-03</td>
</tr>
<tr>
<td>3.02 Budgetary accounting, reporting and audit</td>
<td>&quot;</td>
<td>RF/CS/3.3</td>
<td>QCBS</td>
<td>Oct-00</td>
<td>Dec-00</td>
<td>Jul-01</td>
<td>Feb-04</td>
</tr>
<tr>
<td>3.03 Expenditure and public sector restructuring</td>
<td>&quot;</td>
<td>RF/CS/3.4</td>
<td>QCBS</td>
<td>Oct-00</td>
<td>Dec-00</td>
<td>Jul-01</td>
<td>Feb-04</td>
</tr>
<tr>
<td>3.04 Debt management system</td>
<td>&quot;</td>
<td>RF/CS/3.5</td>
<td>QCBS</td>
<td>Oct-00</td>
<td>Nov-00</td>
<td>May-01</td>
<td>Feb-04</td>
</tr>
<tr>
<td>3.05 Regional budget procurement system</td>
<td>&quot;</td>
<td>RF/CS/3.6</td>
<td>QCBS</td>
<td>Nov-01</td>
<td>Jan-02</td>
<td>Jul-02</td>
<td>Aug-04</td>
</tr>
<tr>
<td>3.06 Regional fiscal management guidelines and best practice standards, develop regional and local public finance manual</td>
<td>&quot;</td>
<td></td>
<td></td>
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</table>
### 4. Sectoral Public Expenditure Reviews

<table>
<thead>
<tr>
<th>Sector</th>
<th>Consultant</th>
<th>Reference Code</th>
<th>CBS Dates</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing/Utilities</td>
<td>&quot;</td>
<td>RF/CS/4.1</td>
<td>Nov-99</td>
<td>Dec-99</td>
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<tr>
<td>Education</td>
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<td>RF/CS/4.2</td>
<td>Nov-99</td>
<td>Dec-99</td>
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<tr>
<td>Health</td>
<td>&quot;</td>
<td>RF/CS/4.3</td>
<td>Nov-99</td>
<td>Dec-99</td>
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<tr>
<td>Social Protection</td>
<td>&quot;</td>
<td>RF/CS/4.4</td>
<td>Nov-00</td>
<td>Dec-00</td>
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<tr>
<td>Culture and Recreation</td>
<td>&quot;</td>
<td>RF/CS/4.5</td>
<td>Nov-00</td>
<td>Dec-00</td>
</tr>
<tr>
<td>Public Transportation</td>
<td>&quot;</td>
<td>RF/CS/4.6</td>
<td>Nov-00</td>
<td>Dec-00</td>
</tr>
<tr>
<td>Industry, Construction and Agriculture</td>
<td>&quot;</td>
<td>RF/CS/4.7</td>
<td>Dec-00</td>
<td>Jan-01</td>
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<td>Law Enforcement</td>
<td>&quot;</td>
<td>RF/CS/4.8</td>
<td>Dec-00</td>
<td>Jan-01</td>
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<tr>
<td>Regional/Local Governance</td>
<td>&quot;</td>
<td>RF/CS/4.9</td>
<td>Dec-00</td>
<td>Jan-01</td>
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</tbody>
</table>

### 5. Project Management

#### A. Operating Expenses FER

i. Staff
ii. Consultants
iii. Fixed Assets
iv. Rent
v. Communications
vi. Property Insurance
vii. Operational Expenses
viii. Travel
ix. Staff Training
x. Conferences/Seminars
xi. Project Audit

<table>
<thead>
<tr>
<th>Category</th>
<th>Reference Code</th>
<th>CBS Dates</th>
<th>Dates</th>
</tr>
</thead>
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<tr>
<td>Goods</td>
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<td></td>
</tr>
<tr>
<td>NSH</td>
<td></td>
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</tbody>
</table>

#### B. Incremental Operating Expenses FMD

i. Staff
ii. Consultants
iii. Travel
iv. Fixed Assets
v. Operational Expenses
vi. Communications (tel/fax/post)
vi. Miscellaneous
viii. Staff Training
ix. Conferences/Seminars

<table>
<thead>
<tr>
<th>Category</th>
<th>Reference Code</th>
<th>CBS Dates</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods</td>
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<tr>
<td>NSH</td>
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<tr>
<td>Procurement Method</td>
<td>Contract Type</td>
<td>No. of Packages</td>
<td></td>
</tr>
<tr>
<td>--------------------------</td>
<td>---------------</td>
<td>-----------------</td>
<td></td>
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<tr>
<td>Goods</td>
<td>G</td>
<td>11</td>
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<td>Int'l Competitive Bidding</td>
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<td>National Shopping</td>
<td>NSH</td>
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<td>Consultant Services</td>
<td>CS</td>
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</tr>
<tr>
<td>Quality and Cost Based Selection</td>
<td>QCBS</td>
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<tr>
<td><strong>TOTAL</strong></td>
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<td><strong>31</strong></td>
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</tr>
</tbody>
</table>
RUSSIAN FEDERATION — REGIONAL FISCAL TA PROJECT

TERMS OF REFERENCE

About the Project:

The Project seeks to contribute to the reform of Russian sub-national government finance across a broad front, both geographically (six regions) and functionally (all aspects of sub-national fiscal management). It is both ambitious and complex, and involves a significant number of separate but interdependent components of technical assistance, which must work effectively together if the Project is to achieve its goals efficiently and on time.

The Project consists of four major components of external TA, each of which will be procured as a whole, but consists of a number of sub-components. The major components are:

1. Strengthening Federal Legislation on Intergovernmental Fiscal Relations and Sub-national Public Finance
2. Strengthening Federal Monitoring Capacity and Development of Standards for Regional Finance Management
3. Assistance to Sub-National Governments in Accounting and Budgeting
4. Sectoral Public Expenditure Reviews.

It is essential that work on each of these components takes full account of (and where relevant also contributes to) work that is being done on the other components. The Project covers ground that also is being or has been examined by other Russian- or donor-financed work ("Associated Projects"). It is important that due account is taken of this work, and that it is incorporated where appropriate as inputs into this Project.

Project Management: Fiscal Monitoring Division ("FMD") and Foundation for Enterprise Restructuring:

Project implementation will formally be handled by the Foundation for Enterprise Restructuring (FER), but day-to-day management will be provided by the Fiscal Monitoring Division (FMD) of the Ministry of Finance, which is intended to become the focal point for management standards in Russian regional finance, and the central repository for all information about regional finances.

FMD will also have an advisory role in recommending legal and extra-legal standards for all aspects of regional government finance in Russia, including advice to the Inter-Ministerial Working Group (IMWG) on improving all aspects of budgeting, accounting, and the preparation of financial reports for electors/tax-payers, central government, management, suppliers and creditors; and the setting of standards for financial management generally in regional government. FMD will advise the IMWG on the desired content and structure of legislation and regulation, (including "extra-legal" instruments such as a code of Good Practice with compliance encouraged by incentives, as opposed to legal requirements where non-compliance is penalized by legal sanctions).
More specifically, FMD will perform the following functions:

- developing and specifying the regulatory standards for monitoring regional finance;
- establishing the tools for monitoring regional finance;
- specification of monitoring needs for each of the identified future functions
- monitor compliance with federal requirements, for purposes of authorizing federal Budget Transfers;
- developing research- and databank.

The FMD is therefore responsible (under IMWG and MinFin authority) for the direction and integration of the various parts of the Project within the Terms of Reference, and for using its discretion to ensure that TA resources are used as efficiently as possible to cover the areas of greatest incremental need, including organisation of routine exchange of information between the contributors to the TA, and by running a "steering committee" for the Project. Providers of TA will be expected to contribute to this forum, and to receive direction from it, within their terms of reference.

**Concept Paper:**

A paper entitled "Concepts of Intergovernmental Fiscal Reform in the Russian Federation, 1999 - 2001", prepared by the Government of the Russian Federation in 1998, defines the objectives, particularly in respect of intergovernmental issues. The FMD will be available to help provide updates and interpret priorities in the implementation of this paper.

**Inventory, Associated Projects:**

An Inventory of Associated Projects, covering other TA work on topics similar to those under the Project, will be provided to prospective bidders for TA work hereunder. (A draft is attached as Schedule xxxx) No assurance is given that this Inventory is yet complete, and no guarantee is given as to the quality of the output from the activities listed in this Inventory.

The Associated Projects are those where the subject matter overlaps particularly closely with the goals of this Project, where the quality of the work is regarded as good, and which in many cases formed known antecedents of the Project. Of particular importance will be a series of diagnostic studies and reform plans to be undertaken with IBRD loan funding in parallel with this Project, in the six subjects participating in this Project - but Associated Projects are in no sense limited to these studies. Attention should therefore be given to the output of all Associated Projects, and active working dialogue be established wherever possible.

Wherever possible, output material from the Associated Projects will be made available via the FMD to those working on TA components of this Project - this material will eventually form one core component of a library to be developed by FMD in the course of this Project.

Conversely, it is expected that all other suitable source material created or located by those working on the components of this Project, that is not yet in the Inventory, will be passed on for inclusion in the Inventory and in the library, and to that extent be in the public domain.
**Timetable demands:**

Many of the tasks described in the TOR will be more efficiently and more effectively executed if proper communication is established with relevant other components in this Project, or from Associated Projects. A strengthened and more consistent legal environment requires establishment of what the law is intended to achieve, and what contradictions exist in current legislation. Regional reform plans will be more satisfactory if they correctly understand the direction of forthcoming legal and regulatory change - while legal and regulatory change will be more successful if it responds to actual circumstances in the regions. If time and cost were no object, then each task could be discrete, with its precedent needs dependent only on its own research. In reality, outputs from the Project are required urgently, and much of the precedent need is already largely or partially satisfied by Associated Projects. Other precedent needs of some components are a direct topic for other components.

Those invited to contribute TA under this Project will be required to inform themselves as closely as possible about the output of the Associated Projects and other relevant components of this Project, to evaluate it and wherever possible to incorporate it in early provisional recommendations, that will allow dependent activities to move ahead. In due course, providers of TA will be expected to verify or correct the implied assumptions about the validity of this precedent work, and where necessary to issue amended recommendations.

Many of the components of this Project therefore call for Provisional Outputs, based on work assimilated from elsewhere (Associated Projects, or other components of this Project), to allow dependent work to get started on a timely basis; and later Definitive Outputs, involving the verification (or amendment) of the provisional conclusions, and the generation of the definitive outputs.

The FMD, in its project management capacity, will assist in the flow of this inter-task and Associated Project information.
PROJECT COMPONENT 1

STRENGTHENING OF FEDERAL LEGISLATION ON INTERGOVERNMENTAL FISCAL RELATIONS AND SUB-NATIONAL PUBLIC FINANCE

1. Background

The Russian Federation has undergone significant reforms in its system of intergovernmental fiscal relations over the past six years. The Budget Code, approved by the Duma, and Part I of the Tax Code that became effective in January 1999, address many aspects of two of the four pillars of any system of intergovernmental fiscal relations: fiscal management and budgeting, and revenue and tax assignments, respectively. The two other pillars of a system of intergovernmental fiscal relations, expenditure assignments and the system of transfers will need to be addressed in separate legislation.

Lack of clarity in expenditure assignments between the federal, regional, and local governments continues to be a vexing problem in the system of intergovernmental fiscal relations in the Russian Federation. The issue of expenditure assignments is addressed in the Budget Code but without sufficient detail and clarity. Lack of clarity in expenditure assignments and the extensive use of unfunded expenditure mandates from upper-level governments threaten to result in inefficient expenditure patterns and fiscally irresponsible behavior.

The Government introduced a formula-driven system of equalization transfers in 1994, the Federal Fund for Assistance to the Regions (FFSR). This system was changed every year since its introduction and it was practically abandoned in the formulation of the 1998 budget. All parties involved, the Government, the regions and the Duma were dissatisfied with the performance of the FFSR. The Government will be using a new but temporary formula for the 1999 budget. The Government has announced its intention of overhauling the system of transfers for future years starting with the budget for 2000.

Much of the reform process over the past six years has focused on the fiscal relations between the federal and regional governments. Less attention has been given to intra-oblast intergovernmental fiscal relation issues. The general budgetary principle has been that the regional governments had the freedom to organize their system of intra-regional fiscal relations in any way they saw fit. Although some regions have moved to reform their budgetary relationships with local governments in a more stable and transparent fashion, the majority of the regional governments are still using a budgetary approach based on negotiation and bargaining, the benchmark that characterized the budget system prior to 1992. In 1997, the Law on the Financial Foundations of Local Self-Governments mandated to the regions the introduction of reforms such as minimum sharing rates for tax revenues with local governments and the use of formula-based transfers. But these provisions contain only general principles and concrete applications still await development. Most regional governments appear to have delayed the introduction of formula-based transfers because of a lack of understanding on how to proceed.

Over the past several years the budgetary process and fiscal management at the federal level have been subject to significant changes and improvements in the Russian Federation. A modern budget classification system based on the IMF's Government Finance Statistics has been
introduced, a Treasury function for budget execution is near completion, and ex-post audit is performed by the Chamber of Accounts.

However, budgeting and fiscal management at the sub-national level in the Russian Federation, with some possible regional exceptions, has failed to keep pace with the reforms at the federal level. The budget formulation process basically has not evolved from the previous regime's practices, there is no modern treasury function for budget execution, ex-post audit is spotty and there is no evaluation of budget policies. While the newly approved Budget Code attempts to address some of these deficiencies at the sub-national level, it does not address in sufficient detail the necessary reforms in financial management, accounting and reporting at the regional and local level. There appears to be a consensus that a sub-national government budget code will be necessary to deal appropriately with all outstanding issues.

In most subjects, intra-regional budgetary relations are still characterized by expenditure assignments between the regional and local governments that lack clarity and stability. In addition, the problem of unfunded expenditure mandates from the regional authorities to local governments continues to be a source of friction and inefficiency in the use of scarce budgetary funds. Finally, in most subjects revenue assignments still lack transparency and predictability, thus detracting from the ability of local governments to plan ahead and destroying any incentives local governments may have to mobilize their own revenues. Fundamental reform of intra-subject intergovernmental fiscal relations faces the handicap of lack of incentive for regional governments to reform. Regional governments tend to feel quite comfortable with the current negotiated system because it provides them with discretion and flexibility.

An issue of significant importance is the exercise of fiscal responsibility by sub-national governments in the area of borrowing. While the new Budget Code will restrict and impose limits on the ability to issue bonds and use other forms of borrowing by sub-national governments, and these should be further developed in a sub-national budget code, there is at present no adequate reporting system and mechanism for enforcement of sub-national borrowing limits by the federal authorities. Some time in the future this control may be exercised by the capital markets themselves but at the present time direct control by the federal authorities is necessary. Lack of enforcement of borrowing limits is likely to be destabilizing at the national level, compromising macroeconomic stability.

It should be clearly understood that ex-ante controls by the Ministry of Finance or any other federal authority of borrowing by sub-national governments will be unnecessarily restrictive and bureaucratic. The limits on sub-national borrowing in the Budget Code are of a regulatory ex-post nature, and they do not grant any powers to the Ministry of Finance to approve ex-ante borrowing by sub-national governments. What still needs to be addressed is how the federal authorities will ensure ex-post that sub-national governments do respect the borrowing limits introduced in the Budget Code and what means or powers need to be granted to the federal authorities. The development of adequate disclosure rules for the fiscal health of sub-national governments should contribute to the foundations for the creation, in the future, of a self-policing system for sub-national borrowing within the capital markets themselves. This will be the most effective and efficient way to impose fiscal discipline among sub-national governments. The sub-national budget code will need to address loan default and bankruptcy proceedings for sub-national governments.
There is one last aspect of the overall legal framework governing the system of intergovernmental fiscal relations which requires attention. Over the past six years many laws have been passed on budgeting and financial management, revenue sharing, transfers, and assignment of functional responsibilities. In addition, there has been considerable variation in the degree of enforcement of these laws. In some cases, the laws have not been much more than proclamations with practically no implementation. As a consequence, inconsistencies and contradictions among several of these laws are quite common. The most recent example is provided by the contradictions between the Budget Code and the Law on the Financial Foundations of Local Self-Government concerning the budgetary relationships between regional and local governments. A systematic study of all current legislation on intergovernmental relations pointing out inconsistencies and contradictions is needed to get rid of this significant source of confusion in the system.

2. Objectives

This project component has the following objectives:

- Assisting the Government with a systematic review of all current legislation on intergovernmental fiscal relations with the goal of eliminating contradictions and inconsistencies.

- Assisting the Government in documenting and analyzing the current assignment of expenditure responsibilities between the federal, regional, and local governments, which would help the Government in the drafting of the Law on the Assignment of Functional Responsibilities.

- Assisting the Government in development of legislation and regulation on revenue sharing and tax responsibilities of regional and local authorities.

- Assisting the Government in the analysis of different options for reforming the current system of transfers, which the Government would use as a basis for drafting of the legislation on Intergovernmental Transfers.

- Preparing recommendations for the Government on federal regulations for monitoring the fiscal performance, budgeting, accounting and fiscal management at regional and local level.

- Assisting the Government and participating regions in the design of model legislation and recommendations on intra-regional fiscal relations, including prototype formula-based equalization transfers, expenditure assignments between the regional and local governments, in the design of stable and transparent revenue sharing between the regional and local governments, and with training in the implementation of these new systems.
3. Outputs and Indicators

A. Intergovernmental Fiscal Relations

The consultants will be required to research, analyse, and report and recommend on all aspects of intergovernmental fiscal relations, both at the federal/subject interface, and intra-regionally. Inputs in this context will include a close understanding of the Concept Paper, a full knowledge of the extensive Associated Project work, review of the material generated by the regional diagnostic reviews in component 3, and further research as necessary.

Outputs will be required to cover:

- the consistency and effectiveness of the legal framework for intergovernmental fiscal relations in Russia;
- the assignment of revenue streams and taxing rights, and of spending responsibilities, and any required changes in legislation to achieve the recommendations;
- a mechanism for intergovernmental transfers that achieves Concept Paper goals;
- model legislation and federal regulation for inter-governmental and intra-regional fiscal relations.

_Provisional outputs_ (for discussion with FMD) will be required within 6 months of inception, to support particularly the development of Regional Reform Plans being generated by Associated Projects, and the other part of this Component 1, dealing with strengthening and rendering more consistent the legal and regulatory framework generally.

_Definitive outputs_, providing firm conclusions on each of the required issues, will be required on timetable to fit the completion of the Project, and all the dependent tasks within it, before June 2004.

The _principal indicators of success_ within this sub-component will be the extent to which the provisional and definitive outputs on the designated topics are available in time to allow other project components to move forward on schedule, and the extent to which the recommendations are proved to be workable in practice, both in implementation of the regional reform plans (component 3), and in the development of a consistent and accepted legal and regulatory framework (the other sub-component of this component 1).

B. Legal and Regulatory Reform

This sub-component will cover all aspects of law and regulation governing Russian sub-national public finance. The subject matter will include particularly the legal and regulatory process and the instruments thereof, including laws, regulations, and extra-legal instruments (such as the proposed Code of Good Practice). Consultants will be required to identify and recommend steps for rectifying instances of contradiction, or gaps, in existing law and regulation, and to address areas where the existing law and regulation is not effective in promoting the government's objectives and policies, including deficiencies identified elsewhere in this Project.
There will therefore be substantial inter-dependence between this sub-component and other tasks addressing the content and objectives of law and regulation. These include the intergovernmental fiscal relations work (the other part of this component 1), and the functional reviews under component 3. There is substantial existing output from Associated Projects, that will be available from the Inventory, both covering aspects of the objectives of law and regulation, and identifying areas of deficiency or opportunity in the legal/regulatory structure.

The topics to be addressed in this sub-component, from such a legal/regulatory perspective, include:

- Constitutional and regulatory mandates, including boundaries and limitations to the legal and regulatory process, and the basis and scope for incentive-backed "extra-legal" instruments such as the code of Good Practice.
- Definition of revenue rights and expenditure responsibilities (close ties to intergovernmental sub-component)
- All aspects of budget preparation and execution; provision for multi-year commitments in capital budgets and debt service (close ties to relevant parts of component 3)
- Accounting, disclosure, and the establishment of accountability (close ties to relevant parts of component 3)
- Debt, debt limitations, and bankruptcy procedures and remedies (close ties to relevant parts of component 3)

_Provisional outputs_ will be required within 6 months of inception, and themselves depend significantly on input from the inter-governmental work under sub-component 1, and the functional reviews from component 3, as well as study of the Associated Projects. The provisional outputs will consist of identification of contradictions, gaps, and early-identified requirements for reform. These will be required to inform the regional reform programmes, and as a basis for the FMD to make recommendations via IMWG to the Russian government for specific reforms.

_Definitive outputs_ will be required on an agreed timetable that may vary between topics, and be determined by the extent/quality of Associated Project material, and the needs for progress elsewhere in the Project. These outputs will consist of conclusive recommendations on each of the topics designated, to cover the direction, the manner, and the instrument of reform, to achieve purposes agreed by Russian government after consideration of the Provisional outputs.

The _principal indicators of success_ in this sub-component will be the extent to which the provisional and definitive outputs on the designated topics are available in time to allow other project components to move forward on schedule, and the extent to which the recommendations are proved to be workable in practice, both in implementation of the regional reform plans (component 3), and in the adoption by the Russian government of the recommended reforms.
PROJECT COMPONENT 2

STRENGTHENING OF FEDERAL MONITORING CAPACITY AND DEVELOPMENT OF STANDARDS FOR REGIONAL FINANCIAL MANAGEMENT

1. Background

Among the weakest aspects of the system of intergovernmental fiscal relations in the Russian Federation is the lack of mechanisms for monitoring by the federal authorities of fiscal performance by regional and local governments. At the present time, regional governments are under the obligation to report the execution of the consolidated regional budgets (regional government budget plus the combined budgets of all local governments in the region). However, this reporting is insufficient to provide the necessary information on compliance with federal policies (such as cost recovery on public utilities), actual budgetary practices (such as the existence and importance of extra-budgetary funds), or the level or extent of fiscal equalization across local governments.

The limited and aggregated nature of financial reporting by regional and local governments does not allow, at the present time, establishment of a clear picture of their fiscal health. Even though regional governments report consolidated budget data to the Ministry of Finance, these data reveal little information on the actual deficit position of sub-national governments on a commitment or accrual basis. For most cases, the budget data provides insufficient information to evaluate the size, change and age of existing budgetary arrears. The budget data available provide no information either on the revenue costs to regional and local budgets of tax preferences granted to enterprises, nor actual lending or loan guarantees by regional and local governments to enterprises. Nor has there been little consistent information on the level of borrowing, debt service requirements, and composition of debt for regional and local governments. The transparency, and ultimately the validity, of sub-national budgets is also compromised by the lack of disclosure and information on extra-budgetary accounts and the use of non-cash payment methods.

The lack of quantitative information in regional and local reported budget accounts is complicated by the lack of information and uniformity on budgetary procedures and accounting systems. There is little information on the constraints that are placed on the use of extra-budgetary accounts by agencies (and even by departments or divisions within administrations), and what the existing reporting requirements and safety checks are. There appears also to be a wide array of practices across regional and local governments in budget planning arrangements, including revenue forecasting, current expenditures and capital investments. Very few regional and local governments appear to have in place an appropriate treasury function with cash and debt management and reporting of budget guarantees. A wide variety of approaches are used by regional governments to fund local governments. Non-transparent arrangements including non-repayable loans and mutual settlements appear to be quite common. In general, there is little information about the degree of compliance by sub-national governments with federal norms pertaining to the budget process and fiscal management and less information on actual budgetary practices by sub-national governments in those areas where the law gives them discretion.
2. Objectives

This project component has the following main objectives:

➢ To execute or commission research into fact and practice in local government finances in Russia. Much of the factual product of this research will be in the public domain, serving as a "library" of information on Russian regional finance. However, some analytical conclusions may be closely held within government.

➢ To advise the Government, IMWG and the Ministry of Finance on improving all aspects of the legal and regulatory framework for regional government finances in Russia. This will include all aspects of budgeting, accounting and the preparation of financial reports for electors/taxpayers, central government, management, suppliers and creditors; intergovernmental fiscal relations both Federation/Subject, and Subject/City-Rayon including inter alia tax and expenditure assignments and inter- and intra-governmental fiscal transfers; and the setting of standards for financial management generally in regional governments. FMD will both advise the IMWG on the desired content and structure of legislation/regulation, and assist in coordinating the drafting and promulgation in a timely and consistent manner.

➢ To provide ongoing monitoring and supervision of all aspects of Russian regional finance within the revised regulatory framework on the basis of the data collected through its research. FMD will make regular recommendations to the Government, IMWG and the Ministry of Finance on a wide variety of questions related to the fiscal reform in the regions.

3. Outputs and indicators

A. Standard Monitoring System

The Standard Monitoring System will respond to the Federal Government's need to maintain an up-to-date understanding of the fiscal and financial condition, and the state of compliance with federal legislation and regulations, of each of the 89 Subjects of the Russian Federation.

Standard monitoring is envisaged as a computer based system, operating primarily on the basis of objective, numerate, non-judgmental inputs fed through a structure that so far as possible builds upon or adapts existing data sources, rather than creating entirely new structures.

The main tasks within this sub-component will be to:

- Specify the indicators that should be tracked to achieve the purposes of Standard Monitoring; these are likely to include compliance with all the main provisions of Russian sub-national public finance law and regulation, including particularly the setting and execution of budgets within legal constraints, the level of debt, the level and dynamic of deficits, and the manner (cash or offsets) of budget execution.
• Identify sources and flows of data that can be used for this purpose; and specify the
deficiencies in form, content, accuracy or verification status of this data, and what
needs to be done to make it available in acceptable form.

• To specify and design the mechanisms for collecting and presenting this data routinely,
in as near as practicable to real-time, including the computer and communication
systems required.

• To specify the personnel and systems resources required to install this mechanism, and
to assist the FMD in its implementation, including systems design, recruitment and
training.

Associated projects and preliminary work suggest that substantial data resources and flows
already exist, but that they are badly co-ordinated, and not used systematically to address issues
relevant to the needs of Standard monitoring; moreover, current legal and regulatory structures
have meant that the information is often not in form and content as useful as would be desirable.

The development of monitoring needs will therefore require substantial dialogue with the
development of accounting and reporting needs and with the development of legal and regulatory
structures. This dialogue forms part of the provisional output of each of the activities
participating in it.

Provisional Outputs: specification of the form and content of input data required (to enable
the reform plans of participating regions to incorporate these regions as "pilots" for the
monitoring process), and discussion with the relevant functional experts of any changes to the
accounting and disclosure requirements desirable to improve the disclosure and accuracy of key
variables.

Definitive Outputs: specification, implementation and delivery to FMD, of a working
system to achieve the goals of Standard Monitoring.

Principal Indicators of success at the provisional stage will be the recognition of
monitoring needs into the main functional reviews (particularly accounting, debt, and treasury);
the inclusion of monitoring info-source requirements in the specifications for regulatory change;
and the inclusion of Standard Monitoring data provision in the reform plans for the participating
regions as "pilots".

B. Extended and Special Monitoring System & Ratings

Extended Monitoring is intended to provide the mechanism by which the Federal
Government can develop a closer understanding of financial and economic circumstances, and
the degree of reform attainment, in regions which are participating in the current Project, or
which are seeking conditional credits or other discretionary benefits from the federal
government. Such regions will also be required to participate in Standard Monitoring - the
Extended requirements are incremental, not substitutes.
To the extent that such discretionary benefits are available as an inducement for desired reforms, when penalty sanctions may not be available for constitutional reasons, Extended Monitoring will provide the main tool for determining where such discretion should be granted, and hence be a substantive instrument of policy. Extended monitoring may also serve a secondary purpose, in helping with the analysis of the effects of other grants and policy actions undertaken e.g. in response to the intergovernmental fiscal analysis.

This sub-component addresses both the specification of the Extended Monitoring standards, and the design and construction of mechanisms for tracking attainments against those standards. As with Standard Monitoring, this will include:

- Specifying the indicators to be monitored.
- Specifying the data and information sources required to monitor them, and identifying any enhancements required to render current sources of such data effective for this purpose.
- Specifying and designing the mechanisms for collecting and analysing this data, including the computer and communication systems required, and the extent of local representation.
- Specifying the personnel and systems resources required to implement the recommendations, and assisting FMD in the introduction of an effective Extended monitoring capacity within the Project's timetable.

The Extended Monitoring standards themselves are likely to be closely related to the standards specified in the Code of Good Practice, but may also contain a number of other quantitative (creditworthiness) or qualitative (governance) indicators designed to provide a close understanding of compliance, and of commitment and attainment in the implementation of reforms. The standards involved will be graduated and progressive to provide a measure attainment, and provide a basis for incentives, across a wide range of levels of attainment.

The evaluation based on these criteria is then likely to be used as a basis for an internal "rating" of sub-national governments, as well for specific discretionary credit decisions.

Substantial components of the Extended Monitoring requirements are likely to be available from the provisional output of sub-component 3, from Associated project material, and from the IBRD's loan conditionalities. Equally, the provisional conclusions from this sub-component as to what will be suitable components of Good Practice will be required as provisional input to the regional reform plans and the development of the extra-legal framework in Component 1. Given its extra-legal character, it is desirable that the Good Practice Code is the subject of extensive consultation and explanation with the regions to which it will apply, and that so far as possible its contents are accepted by and agreed with them. This work will interlock closely with the FMD's overall co-ordinating role in the Project.
Provisional outputs will therefore consist of contribution to the specification of the standards of Good Practice, and the data flows, analytical resources, and all other faculties necessary for the continuing appraisal of reform implementation in the six initial participating regions, and the definition of the resources required to deliver this appraisal on a continuing basis, for an increasing number of regions.

Definitive Outputs Implementation of the appraisal structure, and its successful operation to produce a means to monitor progress of the participating regions. Installation of the graduated rating process, and its application to a widening cadre of regions. Publication of the Code of Good Practice, and its development after debate into an accepted standard for reform oriented regions to aspire to.

The principal indicators of success in this sub-component will be the extent to which the provisional and definitive outputs on the designated topics are available in time to allow other project components to move forward on schedule. The extent to which the Code of Good Practice is really accepted by the participating regions — and by other investors, thereby deepening the incentive for its adoption by other regions — will be important, as will be the extent to which it provides a continuum of incentive across a range of attainments, rather than a single-standard hurdle.

C. Fiscal Statistical Database

The FMD, in its co-ordinating role for regional finance generally, will operate a central information resource on behalf of regions and all other interested parties. Much of this information will be in the public domain; but some aspects of it may be designated as restricted to certain categories of user, or for internal use only.

The topics to be covered by this information resource should be available in paper or electronic form, and should be accessible through a website to be created for the purpose.

The topics will include:

- Regional Budget statistics, developed from the Standard Monitoring data flow.

- Additional budget and economic statistics, developed from other data sources, to provide greater transparency for comparison between regions, and as a basis for external investment decisions and government policy research.

- Definitive statements of Good Practice standards and the proposed public finance detailed application manual and background material on their introduction in practice (where, how, what tools).

- An Inventory of donor funded and other work in Russia (including training materials), that can serve both as a theoretical basis and as a practical "toolkit" for the implementation of public finance reforms in the directions required.

The contents of this library will almost all be the product of other sub-components of this Project, and hence dependent on that other work; the task of this sub-component will be the assembly and presentation of this material. Conversely, the product of this resource will be an
important ingredient for the wider take-up of the reforms promoted by this Project. It is particularly important that it is presented and publicised in such a way as to be seen by regions as a resource useful to them, rather than an imposition on them.

The tasks of this sub-component will be the detailed identification of content; the identification of sources; the specification of the necessary communication and computer facilities to collect, store and present the data; the specification of premises, personnel and other logistical resources required; and the implementation of these objectives within the life of the Project.

The Provisional outputs of this sub-component will include participation in the specification of the data content and format required for monitoring, and in the identification and dissemination of suitable Associated Project material to allow other components to make rapid progress towards their respective tasks.

The Definitive outputs will be the installation and operation of a mechanism for the collection storage and delivery of the specified data categories.

The Indicators of success will include both the mechanical accomplishment of the required outputs, to a timescale that facilitates the completion of other project components on time, and also the acceptance of the resource by regions, investors, other parts of government, and third parties, as a definitive resource and a helpful contribution towards their own goals.
PROJECT COMPONENT 3

ASSISTANCE TO SUBNATIONAL GOVERNMENTS IN ACCOUNTING AND BUDGETING

1. Background

Current Russian budget rules and accounting conventions are clearly at odds with the western “Best Practice” standards: rigid use of a cash (rather than accrual) convention; lack of balance sheets or reliable asset/liability ledgers; inconsistent consolidation of sub-districts and of extra-budgetary funds; lack of proper distinction between operating and capital/financing items are among a few examples of major shortcomings. This has clouded management and public understanding of many real issues resulting in a non-transparent setting of budgets and financial reports by regional governments.

Among many problems are already identified:

➢ The use of a "cash" convention which recognizes transactions only when settled in cash. This has led to a systematic build-up of unsettled accounts payable (not recognized as an expense until paid - hence a budget outcome may be "balanced" simply by not settling the bills; and an apparently balanced budget set on the basis of not expecting to settle the bills);

➢ Unclear and inconsistent consolidation rules which have confused the estimation both of flows of revenues and expenses, and of aggregate liabilities of budget entities;

➢ Lack of reliable asset and liability records and of a balance sheet, which have prevented the normal verification of flow entries through double-entry cross checks;

➢ Absence of accrual conventions which has left some confusion over the true cost for example of zero coupon or foreign currency debt, or the consumption of Capital assets; and hence an inability to know the true cost of services delivered.

Budget formation and implementation has therefore been taking place against a background of falling revenue, rising social need, and uncertainty. Major responses have included cutbacks to near zero in infrastructure investment; a general decline in the level and standards of many services (apparently often with limited capacity to measure the effectiveness or efficiency of services that are provided), in deliberate delays in settlement of many purchase invoices for goods and services; and in an increasing tendency to borrow.

In parallel with this component, a series of regional diagnostic reviews and reform plans is being undertaken in the six participating regions (also funded by IBRD loan finance). Ongoing close dialogue is essential between the consultants undertaking these studies, and the consultants working on this component: recommendations on budget and accounting reform must both respond to the findings of the diagnostic reviews (and a number of other Associated Projects with the same goals in other places), and provide direct guidance back to the reform plans.
2. Objectives

This component has the following objectives:

A. To establish what is the current legal and regulatory environment covering regional and local budget formation and execution, fiscal management, accounting conventions, financial reporting requirements and standards for financial information.

B. To develop recommendations both on the proper objectives and the available means (both legal and extra-legal) of obtaining enhanced financial management and accounting structures.

C. To assist with the installation in participating regions of mechanisms to deliver the required level of budget management, public sector restructuring, accounting and financial reporting.

The end product is intended to be a mechanism for the formation, agreement, implementation, control, and reporting on budgets, that is both more effective in extracting service from limited resources, and more responsive to the needs of the relevant stakeholders.

The relevant stakeholders for this purpose mean first and foremost the electors and taxpayers of the region, acting where appropriate through their elected representatives; central government in its role as a counterpart to fiscal transfers and taxation flows, and as an alternative supplier of services in some instances; and employees, suppliers and creditors who may have a legitimate right to understand the working of a budget on which they are depending for payment of their wages, for their goods and services, or for credit granted.

3. Outputs and indicators

A. Financial Planning, Treasury, & Cash Management

This sub-component addresses each of the functional tasks A B C above, for the captioned activities. Of particular interest will be:

**Financial Planning:** Use of integrated multi-year plan process for budget formation; for explanation/debate vis-à-vis legislators, taxpayers, etc; Revenue forecasting; future debt service capacity (and use in current borrowing decisions — close link to debt tasks); sensitivity analysis (start of risk management) and scenario planning; use to manage expectations towards realism, setting attainable budgets.

**Treasury:** Mechanism for controlling commitments and cash movements in budget execution; role in revenue collection; links between federal (local branch) and sub-national treasury operations; use of software; tie-in to accounting and reporting process (generation of primary accounting data - close link to accounting tasks); tie in to process of creation/management of arrears and accounts payable; tie-in to process of cash and risk management.
Cash Management: Rules and procedures for the management of cash and liquid financial resources; investment in financial instruments; efficient use of cash, transmission, bank credit risk issues; control of bank accounts.

B. Budgetary Accounting, Reporting & Audit

Budget: Rules and procedures for the form of budgets, and the procedures for establishing; federal laws, local laws; relationships between layers; definition of the "boundaries" of budget/off-budget funds, budgetary undertakings, relationship between an administration and its constituent departments; relationship between an administration and its downstream administrations located within its boundaries (cities, rayons).

Specification of main relationships between budget quantities: current vs. capital/finance budgets; balanced budgets, deficits, how deficits to be covered; accounting conventions to be applied.

In all cases, with reference to recently introduced budget code and budget classification laws/regulations, and with the objective of retaining as much as possible of these new laws/regulations as is consistent with the aspirations of Good Practice.

This task may result in proposals for a separate sub-national budget code and budget classification.

Accounting: Formal accounting vs. management information; accounting conventions (cash vs. accrual), chart of accounts; process for generating primary accounting data (links to Treasury); balance sheet, scope for reconcilement of flows to changes in balance of e.g. accounts payable, financial resources; rules regarding inclusion/exclusion of revenue, expense items, assets, liabilities in the accounts; consolidated vs. entity-only accounts; role of accounting and management information in providing cost information for service management; basis of accountability of management.

Reporting: The extent to which information is made available to legitimately interested consumers; transparency; specification of frequency, content; accessibility to consumers.

Audit and Control: Independent verification of compliance with federal/local laws and regulations on budget and accounting information; separation of capacities; review of controls, procedures; verification of entries and quantities; reporting lines of the audit process.

C. Expenditure & Public Sector Restructuring

In close conjunction with the sectoral reviews (components 4), examine/recommend on the means and effectiveness of specifying and delivering services from budget resources. To include the means of allocating budget resources, the means of measuring cost and success in delivering service, and of reallocating resources towards greatest needs. Level of cost recovery, subsidy; scope for reduced subsidy. Transparency of the process; consideration of capital resources as well as current; potential for engagement of private capital, private management, or market resource allocation techniques; impact of such actions on social needs indicators. Contribution to
regional reform plans should include sectoral restructuring for at least two regions on each sector, and at least three sectors for each region.

D. Debt management

Systematic identification of all obligations for which budget is liable; centralised oversight; monitoring of debt capacity (serviced from current revenues, vs. refinancing or asset sales); purposes for which debt incurred - investment, current spending, refinancing, etc; remedies, bankruptcy procedures; relationship to financial planning (future debt service capacity), and to capital budgeting; obligations created on behalf of third parties (guarantees, etc); use of debt to engage in "commercial" activities; debt serviced by non-cash means — in-kind, or by tax offsets; debt limitations — volume/revenue flow, vs. service cost/revenue flow; creation of a debt register (as ingredient of creating enforceable claim), to help police compliance with limitations; risks and risk management capacity.

E. Regional Budget Procurement System

Procedures governing commitment of budget resources; current supply, capital investments; federal laws, local laws; separation of powers; procedures for follow-through to ensure value received - immediate, subsequent follow up; stipulation, maintenance of adequate records of responsibility for procurement decisions.

This topic also includes the capital investment process in the form of selection/procurement of capital assets - what process to establish capacity to finance, identify and follow overall priorities, select investments on objective criteria, procure in disciplined way, implement and follow outcome in short and medium term, with feedback to policies and criteria. Relationship between debt and investment process; procedures for off-budget procurement where possible.

F. Regional Fiscal Management Guidelines, Best Practice Standards, Local Public Finance Manual

This task is essentially the drawing together of the specific functional analysis and recommendations of the components 3 and 4 into a coherent set of recommendations both for targets for broad standards (the Code of Good Practice), and detailed implementation (the drafting of a Manual of Public Finance). Both tasks will have an iterative element, in ensuring that the proposals are internally consistent between different project sub-components, that they are consistent with federal government objectives (by closed liaison with FMD), and that they are realistically attainable within the timeframe specified.

The provisional recommendations necessary to allow this activity to get started are themselves likely to be based substantially on provisional outputs from component 3, and on the Associated Projects. As the Project progresses, these provisional outputs will mature into more definitive outputs based on the refined inputs.

This task will therefore be continuously involved in the assembly and distribution of progressively maturing provisional output, and in two way feedback with the FMD, those involved in the tasks in this component 3, and other components of the Project. The creation of
consistency between the constituents of Good Practice and the Extended Monitoring requirements; the correspondence between the separate functional recommendations and the recommendations for legal reform; and the integration of sectoral reform recommendations into the regional reform programs, will be specific tasks. The collection of the constituent recommendations for Good Practice, and the corresponding detail in the Public Finance manual, will be a task of this sub-component.

For each of these sub-components, provisional outputs will include a substantial contribution to the iterative process of developing the enhanced legal and regulatory environment, and the reform plans for the regions. The definitive outputs will be the eventual specification of the relevant components of Good Practice (in partnership with other contributors), the preparation of the relevant sections of the detailed Public Finance Manual, and the provision of tools and practical implementation techniques to assist in the attainment of the standards specified.

The Indicators of success on each of these sub-components will be the extent to which the analysis identifies real issues, and the consequent recommendations respond with proposals that successfully address these issues in a way that is attainable within practical resource constraints. An understanding by the regions of the reasons for and benefits of the recommendations will be essential. Progress on the regional reform programmes, the creation of the creation of an agreed Code of Good Practice, and the completion of the legal/regulatory reform process, will all be indicators of whether these goals have been achieved.
SECTORAL PUBLIC EXPENDITURES REVIEWS

These reviews will take the form of a series of studies, one for each sector to be examined, to assist regional and local governments in the design of rationalisation strategies for the sector concerned, by costing alternative scenarios, and explaining strategy options for adjustments to the levels of service capacity and unit cost.

The reviews will incorporate analysis of the mechanisms for allocating both operating and investment budget resources between services, and between facilities for each service; for determining unit costs both ex ante (plan and resource decision) and ex post (outcome and analysis of effectiveness); measures for enhancing procurement effectiveness, and increasing budget accountability; benchmarks and comparative performance indices for comparable facilities, both within one region, and between regions.

The reviews must be based on reality, as discovered in the participating regions to be studied, and not some remote ideal drawn from a different environment. The reviews must be conducted in tandem with the diagnostic reviews on regional finance, and each of the 9 sectoral reviews should study at least two of the 6 participating regions in detail; each of the 6 participating regions should be the subject of at least 3 such reviews.

The reviews should incorporate wherever possible as provisional inputs the output from Associated Projects, and the work of the regional diagnostic studies as it relates to financial management. As the Project progresses, there will be increasing output of management tools from other parts of the Project, that can be incorporated into the sectoral reforms.

Each of the reviews should then provide as an output the sectoral reform part of the regional reform plan for the respective regions.

These sectoral reform plans will include recommendations as to:

- Alternatives to the "normative" method of defining required service levels
- Methods of defining unit cost in the service provision, and of constructing models to estimate the sensitivity of unit cost to a variety of scenarios on service volume and cost recovery
- Suggestions on alternative scenarios for reform of both service specification and service delivery, and the costs and other implications of each
- Estimation of the social and poverty-relief consequences of each of the scenarios proposed, including the indirect consequences through release or engagement of resources otherwise required for other services.
- Implementation requirements for each, including specification of the required tools, and guidance on where/how to gain access to the requisite expertise and techniques.
- Investment implications — how to cost, prioritise and finance; where possible, suggest mechanisms to provide for the engagement of private capital and other non-budget resources, such as can facilitate sustained service delivery from increasingly scarce budget funding capacity.

These sectoral reviews will therefore generate *provisional output* in the form of their contribution to the draft regional reform plans, and to the expenditure management component of the functional reviews.

Progressive implementation of the regional reform plans, and the development of the functional reviews, will allow these provisional recommendations to firm up into *definitive output* recommendations during the life of the Project.

*The indicators of success* in these sectoral reviews will be the extent to which they can generate specific action plans that are accepted into the regional reform plans; and the extent to which the action plans prove to be feasible in practice.

The sectors to be covered by such reviews are:

- Housing, utilities:
- Education
- Health
- Social Protection
- Culture & recreation
- Public Transportation
- Industry, Construction & Agriculture
- Law enforcement
- Regional/local governance.
ANNEX 4

SUPERVISION PLAN
<table>
<thead>
<tr>
<th>Approximate Dates</th>
<th>Activity</th>
<th>Staffing Requirements</th>
<th>Staff Weeks</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 2000</td>
<td>Project Launch: Review conditions of effectiveness</td>
<td>Task Team Leader, Economist (Resident Mission)</td>
<td>1 (field)</td>
</tr>
<tr>
<td>April 2000</td>
<td>Supervision Mission</td>
<td>Operational Analyst/Procurement Specialist, Fiscal Finance Specialist, Training Specialist</td>
<td>1</td>
</tr>
<tr>
<td>July 2000</td>
<td>Supervision Mission</td>
<td>Task Team Leader, Economist</td>
<td>1</td>
</tr>
<tr>
<td>October 2000</td>
<td>Supervision Mission</td>
<td>Operational Analyst/Procurement Specialist, Fiscal Finance Specialist, Training Specialist, Economist (Resident Mission), Financial Management Specialist</td>
<td>2</td>
</tr>
<tr>
<td>March 2001</td>
<td>Supervision Mission</td>
<td>Task Team Leader, Economist</td>
<td>1 (field)</td>
</tr>
<tr>
<td>September 2001</td>
<td>Supervision Mission</td>
<td>Operational Analyst/Procurement Specialist, Fiscal Finance Specialist, Training Specialist, Economist (Resident Mission), Financial Management Specialist</td>
<td>2</td>
</tr>
<tr>
<td>March 2002</td>
<td>Supervision Mission</td>
<td>Task Team Leader, Economist</td>
<td>1 (field)</td>
</tr>
<tr>
<td>September 2002</td>
<td>Supervision Mission</td>
<td>Operational Analyst/Procurement Specialist, Fiscal Finance Specialist, Training Specialist, Economist (Resident Mission), Financial Management Specialist</td>
<td>2</td>
</tr>
<tr>
<td>March 2003</td>
<td>Supervision Mission</td>
<td>Task Team Leader, Economist</td>
<td>1 (field)</td>
</tr>
<tr>
<td>September 2003</td>
<td>Supervision Mission</td>
<td>Operational Analyst/Procurement Specialist, Fiscal Finance Specialist, Training Specialist, Economist (Resident Mission), Financial Management Specialist</td>
<td>2</td>
</tr>
<tr>
<td>March 2004</td>
<td>Supervision Mission</td>
<td>Task Team Leader, Economist</td>
<td>1 (field)</td>
</tr>
<tr>
<td>September 2004</td>
<td>Supervision Mission: Review overall Project progress</td>
<td>Task Team Leader, Fiscal Finance Specialist, Training Specialist, Economist (Resident Mission), Financial Management Specialist</td>
<td>2</td>
</tr>
</tbody>
</table>

Note: Supervision plan for Regional Fiscal Technical Assistance Project is prepared based on average costs of supervision for ECSPE projects for the Russian Federation for FY99.
**PROJECT IMPLEMENTATION PLAN**

<table>
<thead>
<tr>
<th>Component</th>
<th>Implementing Agency</th>
<th>Start</th>
<th>Finish</th>
</tr>
</thead>
<tbody>
<tr>
<td>PART A. Strengthening of Federal and Regional Fiscal Legislation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Legal Review</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.01 Inter-governmental fiscal relations, regional budgeting and debt</td>
<td>MinFin, FER</td>
<td>Nov-00</td>
<td>Jun-04</td>
</tr>
<tr>
<td>1.02 Regional Development Fund</td>
<td>MinFin, FER</td>
<td>Jul-00</td>
<td>Apr-02</td>
</tr>
<tr>
<td>PART B. Strengthening of Federal Monitoring Capacity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Developing and Specifying the Regulatory standards for Monitoring Regional Finance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.01 Development of &quot;standard&quot; monitoring system</td>
<td>MinFin, FER</td>
<td>Oct-01</td>
<td>Jun-04</td>
</tr>
<tr>
<td>2.02 Development of &quot;extended&quot; and &quot;special&quot; monitoring systems</td>
<td>MinFin, FER</td>
<td>Dec-00</td>
<td>Jun-04</td>
</tr>
<tr>
<td>2.03 Development of fiscal statistical database</td>
<td>MinFin, FER</td>
<td>Nov-00</td>
<td>Apr-03</td>
</tr>
<tr>
<td>PART C. Assistance to Sub-National Governments in Accounting and Budgeting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Assistance to Sub-National Governments in Accounting and Budgeting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.01 Financial planning, treasury and cash management</td>
<td>MinFin, FER</td>
<td>Dec-00</td>
<td>Sep-03</td>
</tr>
<tr>
<td>3.02 Budgetary accounting, reporting and audits</td>
<td>MinFin, FER</td>
<td>Dec-00</td>
<td>Sep-03</td>
</tr>
<tr>
<td>3.03 Expenditure and public sector restructuring</td>
<td>MinFin, FER</td>
<td>Jul-01</td>
<td>Feb-04</td>
</tr>
<tr>
<td>3.04 Development of debt management system</td>
<td>MinFin, FER</td>
<td>Jul-01</td>
<td>Feb-04</td>
</tr>
<tr>
<td>3.05 Development of regional budget procurement system</td>
<td>MinFin, FER</td>
<td>May-01</td>
<td>Feb-04</td>
</tr>
<tr>
<td>3.06 Development of regional fiscal management guidelines and best practice standards; development of regional and local public finance manual</td>
<td>MinFin, FER</td>
<td>Jul-02</td>
<td>Aug-04</td>
</tr>
<tr>
<td>PART D. Sectoral Public Expenditure Reviews</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Diagnostic Sectoral Public Expenditure Reviews</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.01 Detailed Public Expenditure Reviews for Housing and Utilities</td>
<td>MinFin, FER</td>
<td>May-00</td>
<td>Oct-00</td>
</tr>
<tr>
<td>4.02 Detailed Public Expenditure Reviews for Education</td>
<td>MinFin, FER</td>
<td>May-00</td>
<td>Oct-00</td>
</tr>
<tr>
<td>4.03 Detailed Public Expenditure Reviews for Health</td>
<td>MinFin, FER</td>
<td>May-00</td>
<td>Oct-00</td>
</tr>
<tr>
<td>4.04 Detailed Public Expenditure Reviews for Social Protection Programs</td>
<td>MinFin, FER</td>
<td>Apr-01</td>
<td>Oct-01</td>
</tr>
<tr>
<td>4.05 Detailed Public Expenditure Reviews for Culture and Recreation</td>
<td>MinFin, FER</td>
<td>Apr-01</td>
<td>Oct-01</td>
</tr>
<tr>
<td>4.06 Detailed Public Expenditure Reviews for Public Transportation</td>
<td>MinFin, FER</td>
<td>Apr-01</td>
<td>Oct-01</td>
</tr>
<tr>
<td>4.07 Detailed Public Expenditure Reviews for Industry, Construction and Agriculture</td>
<td>MinFin, FER</td>
<td>May-01</td>
<td>Oct-01</td>
</tr>
<tr>
<td>4.08 Detailed Public Expenditure Reviews for Law Enforcement</td>
<td>MinFin, FER</td>
<td>May-01</td>
<td>Oct-01</td>
</tr>
<tr>
<td>4.05 Detailed Public Expenditure Reviews for Regional/Local Governance</td>
<td>MinFin, FER</td>
<td>May-01</td>
<td>Oct-01</td>
</tr>
</tbody>
</table>
* All Individual Consultants will be procured in strict accordance with the Bank’s Guidelines “Procurement and Selection of Consultants”, with the added measure that each of the assignments will be advertised in both local and international journals to elicit the greatest response possible. From the expressions of interest received the Selection Committee will draw up a short list of no less than three candidates, and select from that list the most qualified individual. These added measures will ensure the greatest degree of transparency and fairness in the procurement process.
ANNEX 6

REPORT ON FINANCIAL MANAGEMENT SYSTEMS
Report on the Assessment of Project for PMR-Based Disbursements

Ineligible for PMR-Based Disbursements

Part I - Financial Management System:

I have reviewed the financial management system relating to this project. The objective of the review was to determine whether the project has in place an adequate financial management system as required by the Bank/IDA under OP/BP 10.02.

My review, which included visits to the project implementing agency, was based on the Bank's guidelines for "Review of Financial Management System", and focused on the assessment of the project's accounting system, internal control, planning, budgeting and financial reporting system, selection of an auditor as well as the format and contents of the Project Management Report (PMR) to be submitted by the borrower in support of Withdrawal Applications.

I confirm that the project satisfies the Bank's minimum financial management requirements. However, in my opinion, the project does not have in place an adequate project financial management system that can provide, with reasonable assurance, accurate and timely information on the status of the project (PMR) as required by the Bank/IDA for PMR-Based Disbursements.

I have detailed in the attachment the inadequacies that I found in the system together with an agreed action plan by the borrower to remedy the situation.

Signed by:
Financial Management Specialist (FMS-OPR)
Andrew Mackie (LOAEL), November 20, 1999

Part II - Procurement/Contract Management System

I have reviewed the procurement/contract management system relating to this project. The objective of the review was to determine whether the procurement/contract management system adopted by the project conforms to the Bank's guidelines for procurement in investment projects.

My review was based on the "Assessment of Agency's Capacity to Implement Project Procurement, Setting of Prior Review Thresholds and Procurement Supervision Plan" guidelines issued by the Bank.
I confirm that the project satisfies the Bank's minimum procurement management requirements. However, in my opinion, the project does not have in place an adequate procurement/contract management system that can provide the appropriate data on major procurement and contract management (PMR - Section 3) as required by the Bank/IDA.

I have detailed in the attachment the inadequacies that I found in the system together with an agreed action plan by the borrower to remedy the situation.

Signed by:
Senior Procurement Specialist __________________________
Karl Skansing (ECC10), November 20, 1999

Part III: Physical Monitorable Indicators and Overall Assessment

I have reviewed the project's system for monitoring physical implementation progress, including its monitorable indicators for major outputs. In my view, the system cannot provide the appropriate data on physical progress (PMR - Section 2) required by the Bank/IDA.

I have detailed in the attachment the inadequacies that I found in the system together with an agreed action plan by the borrower to remedy the situation.

Also, based on the assessments of the FMS-OPR and PS, and/or considering my overall assessment of the project, I am of the view that this project is not suitable for PMR-based disbursements.

Signed by:
Task Team Leader __________________________
Eugene Gurenko (ECSIN), November 20, 1999

Part IV: LOA Reasonableness Review

I have conducted a reasonableness review of the process followed by the Task Team in assessing the project, and I concur with its recommendation that this project is not eligible for PMR-Based Disbursements.

Signed by:
FMS-LOA/DO __________________________
Andrew Mackie (LOAEL), November 20, 1999

* Signed original in project files.
1. Summary and Key Findings

FER is a well-organized PIU with a clearly defined organizational structure and qualified staff. Over the next twelve to eighteen months it is proposed that it will become project implementation unit for three new IBRD loans with minimal increases in staffing with its core finance functions. This is an ambitious aim which will only be achieved if processes and information technology are integrated and automated. In the case of the Migration and Forestry Projects it faces significant capacity building issues within regional project implementation groups. These are issues which are currently being addressed by FER management, but the Bank must also be alert to these accountability issues in project preparation.

The Bank needs to adapt to the challenges posed by multi-project PIU’s by providing greater focus particularly in the monitoring of operational budgets and financial management systems and reporting.

2. General

The Foundation for Enterprise Restructuring and Financial Institutions Development (FER) is a non-commercial, non-profit foundation founded in July 1996. At the moment the founders are Ministry of Finance (MinFin), Ministry of Economy, Ministry of Regional Policy, Central Bank of Russia, Ministry of Transport, Leontief Center and Foundation of Housing Reform, Gosstroy. FER is implementing agency for MinFin on three on-going Bank projects; Financial Institution Development, Enterprise Support, Enterprise Housing Divestiture and preparation of Migration Project out of PDL preparation fund.

It is proposed that FER will also act as implementation agent for Sustainable Forestry Pilot project, Regional Fiscal Technical Assistance project and Northern Out-Migration Pilot project.

2.1. Governance Structure.

Governance over the FER’s activities is through the Board of Directors; a supervisory body consisting of twelve members headed by two Co-Chairpersons (First Deputy Minister of Economy and Deputy Chairman of the Central Bank of Russia) with support of Executive Secretary of the Board. Board meetings are conducted annually or more frequently as required. Minutes are kept for all meetings. The main functions of the Board are to approve:

- changes to the Charter
- major restructuring of activities
- the annual budget
- changes to the organizational structure and staffing (salaries)
- the annual report of FER including audited financial statements
- the structure and composition of Project Management Committees (PMC’s)
The implementation of individual projects is governed by the PMCs which are appointed by the Board of Directors. This has around ten members representative of all key stakeholders. Committees meet regularly with frequency dependent on project activity. The functions of the Committees are to:

- define project objectives and activities
- approve project activities budgets and work plans
- resolve project implementation issues
- define sources of project finance
- approve project participating entities, sub-borrowers etc.
- form contract evaluation committees
- approve Project Directors

The Project Director reports regularly to the PMCs on project implementation.

2.2. Regulations and Procedures.

The activities of FER are regulated by national laws and Bank rules and procedures. The Operational manual of the FER provides clear definitions and instructions on the FER organizational structure, functions of its management bodies, responsibilities of FER departments, job descriptions of staff, employment policy, budgeting and accounting procedures. Project implementation is separately addressing project description, project management system, financial procedures, implementation arrangements, reporting requirements and procurement procedures.

2.3. Organizational Structure and Staffing.

FER’s management team is led by the Director General, supported by two Deputy Director Generals. FER’s functional organization is divided into four budgetary groups: general services and three project groups. General services consist of the following departments: management, secretariat, contract, finance and accounting. FER performs implementing functions for three ongoing projects (FIDP, ESP and EHDP). The general services are responsible for procurement, disbursement, financial management and contract management. Costs of the general services departments are allocated to operating costs categories of all projects in proportion reviewed and agreed by the PMC and approved by the Board.

This requires no overall approval by the Bank although project operating budgets are agreed in advance by task team leaders. Project groups activities are staff which can be budgeted to project specific issues.

The Contract management department handles all issues of procurement, contract monitoring and legal support. Staff of the Department consist of the following: Manager of the Procurement Department/Senior Legal Counsel, Senior Procurement Officer, Procurement Specialist/legal counsel and assistant. The manager of the Department reports to Deputy Director.
The Finance department is headed by Director of Finance supported by three staff; a disbursement specialist and junior disbursement specialist and a specialist on sub-loan management. The Director of Finance department reports to the Deputy Director General. Included within the responsibilities of the Finance Department are the preparation of project financial management reports in conformity with Bank requirements and monthly reporting to the Ministry of Finance.

The Accounting department is headed by Chief Accountant who supported by two permanent staff accountants and one full time consultant. The Chief Accountant reports directly to the Director General. The Accounting Department has responsibility for the production of entity financial statements compliant with Russian legislation and International Accounting Standards as well as compliance with tax legislation.

Staffing policies are addressed in the Operating manual. The recruitment process is transparent and staff turnover is low due to pleasant working environment and good compensation scheme. Staff compensation packages include salary and medical insurance. Staff performance reviews are performed annually. FER’s Operating manual includes the provisions on compliance with “Norms of conduct and business ethics of the FER” for each employee.

Training opportunities exist for all levels of staff and are encouraged by management. Special training on accounting and financial management is financed by the FER. (The Chief accountant studies under ACCA program and Finance Director studies under MBA program).

3. Project Accounting Systems and Procedures

3.1. Accounting Systems and Reporting Requirements.

Current financial reporting is divided onto FER entity reporting which is handled by the accounting department and project financial reporting which is conducted by the Finance Department. The financial reporting system needs to be capable of producing several different types of reports, including:

- Annual project management reports in accordance with Bank requirements
- Quarterly Project Management Reports in conformity with Bank requirements
- Annual FER financial statements prepared in accordance with IAS (maybe transformed from Russian financial statements at the year end)
- Annual FER financial statements prepared in accordance with Russian Legislation
- Reports prepared at request of International Finance Organization Department of the Ministry of Finance and Project Finance Center

Entity accounting is performed on Inotech accounting software package used by approximately fifteen other World Bank projects in the Russia portfolio. Project financial reporting is prepared from withdrawal applications and summarized on an Excel Spreadsheet. In 1998 the Bank required Foundation accounts prepared under International Accounting Standards (IAS) for the first time. At the time of preparing this assessment these financial statements were still outstanding.
There is a lack of interface between project and entity financial statements; a significant issue that exists across the Bank’s entire Russia portfolio. As project financial statements are not part of the double entry bookkeeping system key internal controls such as overall cash reconciliation are not built into the system. These can be addressed by other sub-optimal internal controls, external audit reviews and Bank supervision but the medium term solution is to more fully integrate the two systems. The program for the integration of the two systems is planned to be completed by December 31, 2000 at the latest. The precise details and extent of the integration will be reviewed as part of the consultancy contract mentioned below.

In accordance with Bank’s requirements FER has to prepare entity’s financial statements annually in accordance with IAS and Project Management Reports (PMR) quarterly. Management of FER recognize the importance of linking PMR’s to technical analysis of Project Managers and this is being given particular attention in the preparation of the new projects.

In order to meet Bank’s requirements the computerized accounting system of FER need to be strengthened to provide higher level of automatization and internal control. FER is currently addressing this issue through a consultancy contract with the following terms of reference:

- carry out a diagnostic on the status of bookkeeping in the Foundation in accordance with Russian accounting standards and IAS
- develop a procedure to maintain business accounting in FER using available software according to two standards simultaneously
- preparation of operational charts of accounts corresponding to local and international standards

As well as the above the consultant will prepare recommendations and deliver training. The success of this initiative is extremely important in the overall success of the overall operational strategy of FER whose aim is to achieve significant efficiency gains in the face of a growth in activity projected in the next twelve to eighteen months.

In addition to support of the consultant, the Bank agreed to review the overall format of FER’s entity financial reports and the project financial management reports. It is particularly important to Bank supervision that there is a transparent link between entity budgeted and actual operational costs and individual project component costs.

3.2. Budget preparation and execution

Budgets are prepared for all FER’s activities including annual operating budgets. The Board of Directors is responsible for approving annual budgets and ratifies any changes. The Project planning process in performed under guidance of Project Implementation Committees. In accordance with Bank’s requirements actual data on project implementation is compared with the budgets on regular basis. An issue for the Bank is how operational expense budgets within the Foundation are calculated and apportioned to individual projects. The overall annual operating budget of FER will be submitted to the Bank’s Country Unit for no-objection one month prior to submission to the Board of Directors. The Bank’s Country Unit will also review compliance through ex-post monitoring of the financial reports of the Foundation and projects.
3.3. Internal Control Procedures

Internal Control Procedures of the FER are documented in Operational manual, and control procedures are also extensively defined under Russian legislation. FER management completed an Internal Control Questionnaire of the Bank. Procedures cover the following main areas of the project implementation: budget preparation and execution, contract preparation and signing (procurement procedures), disbursement, assets management, etc. As noted above additional procedures are needed in order to ensure the appropriate control over the allocation of general services department costs to project operating cost categories. These will be incorporated into the Operating Manual and are subject to the Bank’s prior approval.

The management of all projects will be through one ruble project account in which counterpart funds and ruble denominated transaction from individual projects Special Accounts are held. If this approach is to be adopted it must be within an environment of sound integrated chart of account and internal control surrounding the reconciliation of the project account. This should be explicitly addressed in the terms of reference of the consultant engaged in the integration of accounting and financial systems. The Bank assessment team has addressed these concerns to the Foundation and if it were not for strength of the management and finance team we would reject the approach in favor of separate ring fenced project account. Nevertheless we support the efforts being made in terms of the efficient project management and trust that, if there optimum system solutions cannot be achieved then they will explore alternative and possibly more expensive options requiring additional finance staff.

3.4 Audit Arrangements.

In accordance with Bank’s requirements, audit of the project will be performed annually in accordance with Standards acceptable to the Bank. Russian auditing company FBK audits each year all projects implemented by FER and Foundation as an entity. In order to ensure a consistent approach to the financial management within the PIU we recommend that the principle of a single auditor for all projects within FER be continued.

4. Conclusion

FER proposes to implement the new projects with minimal growth in central support functions of finance and disbursement. This is to be achieved in part by the impending closure of existing projects. The plan is ambitious and is dependent on significant efficiency and rationalization of system software and internal control procedures. It also carries a significant risk in project implementation as FER tenders for projects with MinFin with limited room for renegotiation during implementation.

Two of the new projects have significant Regional Components (Forestry and Northern Out Migration) and part of FER’s responsibilities will include capacity building, training and compliance with Bank reporting requirements. This is likely to be a significant and time consuming task to be managed with existing finance and accounting staff.

We have found the management of FER addressing these key issues and believe their strategy deserves support pending the outcome of the work by the consultants in their recommendations regarding the accounting systems of the Foundation.
The other key finding is that the Bank needs to address the supervision of key elements of the supervision of multi-project PIU’s on a more integrated basis in relation to the fiduciary elements of financial management, review and approval of operational expenses and reviews of project and entity financial reporting.

PART II. REGIONAL FISCAL TECHNICAL ASSISTANCE PROJECT

1. Governance Structure

The Federal Government has created an Inter-ministerial Working Group (IMWG) to represent their interests in the project. This group is composed of representatives of Ministry of Finance, Ministry of Regional Policy, Ministry of Economy, Apparatus of the President, the Working Center of Economic Reforms and the Foundation for Enterprise Restructuring. To supervise the project activities during project implementation the Board of Directors of FER will approve the IMWG as a Project Management Committee (PMC). This committee will represent both the regional and federal authorities (see paragraph 2.1 for overview of FER’s governance structure and the role of PMC’s).

The project is divided into five components:

Component A - Strengthening of Federal and Regional Fiscal Legislation – this component will provide technical assistance to improve the existing framework of intergovernmental fiscal relations. Counterparts for this component are the Ministry of Finance, State Duma, Federation Council and the Presidential Administration.
Component B - Strengthening of Federal Monitoring Capacity and the Development of Standards for Regional Financial Management-improving compliance of the regions with existing federal laws and regulations.
Component C - Assistance to Sub-national Governments in Accounting and Budgeting - strengthening the Government’s capacity to monitor sub-national fiscal performance and reform efforts.
Component D - Sectoral Public Expenditure Reviews

2. Regulations and Procedures

The Project Operating manual will cover the project description, project management system, financial procedures, implementation arrangements, disbursement procedures and internal control procedures. This manual will be presented for Bank’s review and approval in accordance with the Action Plan.
3. Organizational Structure and Staffing

An Order of the Ministry of Finance was signed on June 29, 1999 establishing a Regional Fiscal Monitoring Unit (RFMU) within the Department of Inter-budgetary Relations, whose role will be to monitor regional finance and to manage this project. Initially this is budgeted to have five MOF staff but this is budgeted to increase to xx over the duration of the Project. This will be headed by Aleksey Lavrov.

To support the MOF staff in the implementation of the project the RFMU will use a number of short term consultants who will report directly to Mr. Lavrov. The project design assumes that as consultancy staff will reduce during the life of the project as Ministry of Finance staff are trained and drawn into the division.

FER would perform the functions of the Project Implementation Unit for the Project. During project preparation and implementation, FER will provide procurement, disbursement, accounting and financial reporting services. Individual consultant contracts are being signed by FER but with accountability clearly to management within RFMU. The following changes will be made in the existing organizational structure of FER (also see Part I for the assessment of the existing structure). Unlike other projects within FER no separate project group will be formed within FER as all technical issues will be dealt with in Fiscal Monitoring Center.

Within the General Services department, two additional procurement specialists will be required within FER. Operating costs of FER will be financed under this loan. The general Services department of FER works on a cost-sharing basis with other projects under implementation by the Foundation.

4. Budget preparation and execution

In accordance with the general budgeting procedure described in the Operating manual, FER’s annual operating budget is approved by the Board of Directors. This budget includes FER’s operating budget and the budget for individual contracts signed by FER. A Project Management Committee is responsible for approving the project budgets.

In accordance with the procedures described in Part I, the overall annual operating budget of FER will be submitted for prior approval of the Bank’s Country Unit, prior to Approval by the Board of Directors.

Quarterly budgets have to be prepared for main projects and each disbursement category. The procedure for establishing quarterly budgets will be agreed between FER and the RFMC and documented within the Operating manual. Annual budgets will be reviewed in the light of project implementation.

5 Project Accounting Systems and Procedures

Under all components consultants contracts will be signed by FER on behalf of RFMC. The agreements reached in order to strengthen project accounting systems are addressed in detail in Part I. Ministry of Finance will issue instructions to the RFMC to ensure records on counterpart funds are provided to FER for the preparation of financial statements.
In addition to the above reporting requirements, FER will submit quarterly Project Management Reports (PMRs) to the Bank. For each quarterly report FMC will prepare a textual analysis of the progress of project implementation, which will be attached to the financial report submitted to the Bank. The composition and format of the Project PMRs will be drafted by FER and the Bank will provide its comments as provided for in the action plan.

FER will be responsible for the preparation of project financial statements for annual audit. Project financial statements should include data on total project expenditures and financing for the reporting period including counterpart funds. Data on counterpart funding will be collated by FER and will be incorporated into the project financial management statements. The principal sources of counterpart funding are Ministry of Finance staff within the RFMC and Regional Staff for Component B plus rental of office space in Ministry of Finance and Regional offices.

6 Disbursement Arrangements

FER will be responsible for compliance with the Bank’s disbursement procedures. FER will initiate payments from the Special Account and, as appropriate directly from the Loan Account.

7 Audit Arrangements

As noted in Part I of the assessment, it is recommended that one auditor is procured for all projects implemented by FER. The appointment of project auditor will be a condition of effectiveness.

8 Conclusion

The overall conclusion is that FER has sufficient capacity to implement the proposed Regional Fiscal Technical Assistance Project effectively, although FER need to pay particular attention to the accountability and internal control procedures within the FMC which has no experience in project management. The following actions were agreed with FER in order to meet the Bank’s financial management requirements prior to project effectiveness.
Proposed Action Plan for strengthening financial management capacity of FMC

<table>
<thead>
<tr>
<th>Item</th>
<th>Responsible Party</th>
<th>Completed by</th>
<th>Bank's Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Development of management structure within RFTA.</td>
<td>FER/MinFin</td>
<td>September 3, 1999</td>
<td>Review and approve</td>
</tr>
<tr>
<td>2. Board of Directors of FER includes Project Management Committee on the RFTA to the Governance structure of FER.</td>
<td>FER</td>
<td>Board Presentation</td>
<td></td>
</tr>
<tr>
<td>3. Project Management Reports (PMR’s) format and content (including quarterly budgets) agreed with the Bank.</td>
<td>FER</td>
<td>Board Presentation</td>
<td>Review and approve</td>
</tr>
<tr>
<td>4. Operating manual on implementation of Regional Technical Assistance Project is prepared for Bank’s review and approval.</td>
<td>FER, FMC</td>
<td>Board Presentation</td>
<td>Review and approve</td>
</tr>
<tr>
<td>5. Appointment of the auditor</td>
<td>FER</td>
<td>Review and approve</td>
<td></td>
</tr>
</tbody>
</table>

The project is certified by a Financial Management Specialist as meeting the minimum financial management requirements prior to Board Presentation. The implementation of the above Action Plan is a condition of effectiveness.
## Concordance Table

**Russian Federation**  
**Regional Fiscal Technical Assistance Project**

<table>
<thead>
<tr>
<th>Agreements Reached and Recommendations in the PAD/PR</th>
<th>Corresponding Section of Legal Documents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower may for the purposes of the Project open and maintain in dollars a Special Account in a commercial bank, acceptable to the Bank, on terms and conditions satisfactory to the Bank.</td>
<td>Article II, Section 2.02 (b)</td>
</tr>
<tr>
<td>Borrower declares commitment to the objectives of the Project, and, to this end, without any limitation or restriction upon any of its obligations under the Loan Agreement, shall carry out the Project primarily through the MOF and FER, all with due diligence and efficiency and in conformity with appropriate administrative and financial practices, and shall provide the funds, facilities, services and other resources required for the Project.</td>
<td>Article III, Section 3.01 (a)</td>
</tr>
<tr>
<td>Borrower, through the MOF, shall enter into a Project Implementation Agreement with the FER, under terms and conditions approved by the Bank.</td>
<td>Article III, Section 3.02</td>
</tr>
<tr>
<td>Procurement of goods, works and consultants' services required for the Project, financed out of the proceeds of the Loan, to be in accordance with the &quot;Guidelines for Procurement under IBRD Loans and IDA Credits&quot;.</td>
<td>Article III, Section 3.03</td>
</tr>
<tr>
<td>Borrower shall cause FER to maintain financial management system, including records and accounts, and prepare financial statements, in accordance with accounting standards acceptable to the Bank.</td>
<td>Article IV, Section 4.01 (a)</td>
</tr>
<tr>
<td>Borrower shall cause FER to prepare, in accordance with guidelines acceptable to the Bank, and furnish to the Bank not later than forty five (45) days after the end of each calendar quarter, a PMR for that period.</td>
<td>Article IV, Section 4.02</td>
</tr>
<tr>
<td>MOF shall be responsible for overall management and implementation of the Project by administration of the timely processing of project-related documents for procurement, disbursement and other matters, in accordance with an internal procedure satisfactory to the Bank.</td>
<td>Schedule 5, Paragraph A 1</td>
</tr>
<tr>
<td>FER shall be responsible for day-to-day technical implementation of the Project, including preparation of appropriate auditing reports and their dissemination to relevant agencies of the Borrower and the Bank.</td>
<td>Schedule 5, Paragraph A 3</td>
</tr>
<tr>
<td>Borrower shall ensure that FER functions in a manner, and with staff, consultants, facilities and other resources necessary — to the satisfaction of the Bank — until the completion of the Project.</td>
<td>Schedule 5, Paragraph A 4</td>
</tr>
<tr>
<td>Borrower, through the MOF, shall be responsible for selecting the Participating Regions in accordance with criteria acceptable to the Bank.</td>
<td>Schedule 5, Paragraph B 1</td>
</tr>
<tr>
<td>Participating Regions to manifest their intention to carry out the Principles of Responsible Regional Fiscal Policy.</td>
<td>Schedule 5, Paragraph B 2</td>
</tr>
<tr>
<td>FER shall by December 1 of each year furnish to the Bank for its review the proposed work program of the FMD, including specific information on expected expenditures, account of such activities, and sources of income, as agreed with the Bank.</td>
<td>Schedule 5, Paragraph C 1</td>
</tr>
<tr>
<td>Borrower shall carry out technical assistance activities through FMD and FER under terms of reference satisfactory to the Bank.</td>
<td>Schedule 5, Paragraph C 2. (a)</td>
</tr>
<tr>
<td>Borrower shall promptly furnish to the Bank through FER a copy of its findings and recommendations upon completion of technical assistance activities.</td>
<td>Schedule 5, Paragraph C 2. (b)</td>
</tr>
<tr>
<td>Borrower shall afford the Bank the opportunity to exchange views on the ex-post review of technical assistance activities.</td>
<td>Schedule 5, Paragraph C 2. (c)</td>
</tr>
<tr>
<td>By December 1 of each year, the FER shall submit to the Bank for review the proposed budget and financing plan for the PIU and FMD.</td>
<td>Schedule 5, Paragraph D 1</td>
</tr>
<tr>
<td>Borrower shall develop, adopt and maintain policies and procedures adequate to enable it to monitor and evaluate the carrying out of the Project and the achievement of its objectives.</td>
<td>Schedule 5, Paragraph E 1</td>
</tr>
<tr>
<td>Borrower shall prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank on or about November 30, 2001 a report integrating the results of the monitoring and evaluation activities performed, and on the progress achieved in the carrying out of the Project.</td>
<td>Schedule 5, Paragraph E 2</td>
</tr>
</tbody>
</table>

* MOF — Ministry of Finance; FMD — Fiscal Monitoring Division; FER — Foundation for Enterprise Restructuring