Report No. 39015-UA

Ukraine
Public Financial Management Performance Report 2006

March 15, 2007

Prepared by the World Bank in conjunction with MoF Ukraine and multiple donor partners.

Poverty Reduction and Economic Management Unit
Europe and Central Asia Region

Document of the World Bank

CURRENCY AND EQUIVALENT UNITS

(Exchange Rate Effective as of March 15, 2007)

Currency Unit	=	Hryvnia
UAH 1.00	=	US$0.20
US$ 1.00	=	UAH 5.03

GOVERNMENT FISCAL YEAR

January 1 – December 31

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS

ACU	Accounting Chamber of Ukraine
ADETEF	Assistance for the Development of Exchanges in Economic and Financial Technologies
CoM	Cabinet of Ministers
CFAA	Comprehensive Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
DFID	Department For International Development
DPL	Development Policy Loan
EU	European Union
GDP	Gross Domestic Product
GFS	Government Financial Statistics
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
KRU	Department of Control and Revision
MDA	Ministry, Department and Agency (first, second, and third-level budget users)
MoF	Ministry of Finance
MoE	Ministry of Economy
NBU	National Bank of Ukraine
PFMPR	Public Financial Management Performance Report
SOE	State-Owned Enterprise
TSA	Treasury Single Account
USAID	United States Agency for International Development

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CONTENTS

LIST OF TABLES

SUMMARY ASSESSMENT

INTEGRATED ASSESSMENT OF PFM PERFORMANCE

1. The Public Expenditure and Financial Accountability Performance Assessment Results are summarized in Table 1 below.

Table 1: PEFA Assessment Results

	Indicator	Score
	A. PFM OUT-TURNS: Credibility of the budget	
PI-1	Aggregate expenditure out-turn compared to original approved budget	B
PI-2	Composition of expenditure out-turn compared to original approved budget	B
PI-3	Aggregate revenue out-turn compared to original approved budget	A
PI-4	Stock and monitoring of expenditure payment arrears	B+
	B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency	
PI-5	Classification of the budget	A
PI-6	Comprehensiveness of information included in budget documentation	A
PI-7	Extent of unreported government operations	D+
PI-8	Transparency of inter-governmental fiscal relations	B+
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	D+
PI-10	Public access to key fiscal information	B
	C. BUDGET CYCLE	
PI-11	Orderliness and participation in the annual budget process	B+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C
	C(ii) Predictability and Control in Budget Execution	
PI-13	Transparency of taxpayer obligations and liabilities	C
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C
PI-15	Effectiveness in collection of tax payments	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	D+
PI-17	Recording and management of cash balances, debt and guarantees	B
PI-18	Effectiveness of payroll controls	D+
PI-19	Competition, value for money and controls in procurement	D+
PI-20	Effectiveness of internal controls for non-salary expenditure	C+
PI-21	Effectiveness of internal audit	C+
	C(iii) Accounting, Recording and Reporting	
PI-22	Timeliness and regularity of accounts reconciliation	A
PI-23	Availability of information on resources received by service delivery units	B
PI-24	Quality and timeliness of in-year budget reports	C+
PI-25	Quality and timeliness of annual financial statements	D+
	C(iv) External Scrutiny and Audit	
PI-26	Scope, nature and follow-up of external audit	D+
PI-27	Legislative scrutiny of the annual budget law	B+
PI-28	Legislative scrutiny of external audit reports	D+
	D. DONOR PRACTICES	
D-1	Predictability of Direct Budget Support	NA
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D
D-3	Proportion of aid that is managed by use of national procedures	D

2. **Credibility of the Budget**. The original approved budget is a fairly reliable guide to government policy. Aggregate expenditures and revenues are close to budget levels, and composition of spending is also close to the original budget levels and in relative priority. The annual process of identifying priorities to be protected during budget execution is working in practice Payment arrears are low, and have been declining, indicating no major issues. Monthly reporting of payables to Treasury can improve.

3. **Comprehensiveness and Transparency**. There is a fairly high degree of comprehensiveness and transparency in central government public finances. Administrative, economic, and program classification exist for the national government, generally following government financial statistics (GFS) standards, providing a good basis for controlling, monitoring, and reporting on expenditures. A comprehensive set of information is included in the annual budget, though the capital spending could be more detailed to show important investment spending trends. Extrabudgetary fund (EBF) operations are reported. Subnational governments operate through the Treasury and cannot expend more than their budget. Public access to key fiscal information is generally good. The major area of weakness is in reporting, oversight and monitoring of other public sector entities, namely state-owned enterprises (SOEs) equivalent to 22 percent of total spending.

4. **Policy-Based Budgeting**. The Ukrainian annual budget process is orderly, allows ample opportunity for policy official involvement and is becoming more policy-based. Addition of a more systematic multi-year perspective and better integration of strategic programs into annual budgeting would further enable policy-based budgeting. The introduction and refinement of program and performance budgeting, and development of a white paper on PFM reform, indicate an active interest in improving the budget formulation process. Some improved performance is possible with relatively simple improvements, such as further development of the spring budget guidelines into a fiscal policy paper for cabinet and the Rada (with multi-year forecasts), and inclusion of multi-year sector ceilings in the Guidelines.

5. **Predictability and Control in Budget Execution**. While able to deliver overall spending targets, the budget execution system is presently characterized by widely varied performance. The mixed results reflect the fragmented nature of the execution system with: (a) no government entity taking overall responsibility or oversight for system operation (e.g., MoF, MoE, ACU); (b) weak coordination or integration of processes spanning organizations (e.g., Treasury-State Tax Service data matching); and (c) uneven modernization of organizations and processes (e.g., Treasury has undergone one modernization and is embarking on a second round while tax, customs, procurement, and civil service have yet to start). While neither Ministry of Finance (MoF) nor treasury undertakes cash forecasting, per se, a system of allocations and warrants do provide some predictability in monthly expenditures and cash flow. Improved personnel and payroll databases linked to monthly payroll would further enhance controls. Tax system weaknesses are a major obstacle to improved revenue collections, and thus also pose a risk for fiscal balance Better PFM assessment scores do appear in areas where modernization has taken place, yielding better system performance. Recent procurement law amendments are not consistent with international standards. Formal internal audit

according to recognized international standards is still under development in Ukraine, but it is partially effective. Traditional compliance inspections do provide some measure of assurance on fund usage and process integrity.

6. **Accounting, Recording, and Reporting**. Ukraine assesses relatively well in most areas of accounting, recording, and reporting of expenditures. Accounts reconciliation is continuous, through the treasury system. The Treasury system provides generally reliable, complete information on most resources received by service delivery units. In-year budget reports are timely and of reasonable quality. The most significant shortcoming of present reporting is the absence of an automated commitment registration and reporting system (under implementation). Reporting quality generally appears high, but the Accounting Chamber did note some problems with appropriate recording of spending. A consolidated government financial statement is prepared quarterly and annually, using the IMF Special Standard on Data Dissemination and including both social insurance and pension fund expenditures.

7. **External Scrutiny and Audit**. External audit and legislative follow-up to audit are not adding as much value as they could, but the legislature is fully engaged in budget formulation and review. The Accounting Chamber of Ukraine (ACU)—the supreme audit institution—is firmly established and well-funded but the nature of the audit is more compliance-oriented with limited performance audits and no attestation of Government financial statements. Audit reports are submitted to the legislature within four months of the end of the fiscal year and findings are released to the media, but there is limited evidence of legislative follow-up to ACU recommendations. The legislature's budget review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue, and the legislature has at least two months to review the detailed budget proposals. Clear rules exist for in-year budget amendments by the executive and are respected.

8. **While there is extensive donor assistance in PFM, donor administrative practices currently do not contribute to building PFM systems.** Most major donors include support for PFM reform in their project portfolios. However, most assistance is donor-executed using parallel process with limited reporting to Government of expenditure in line with budget formulation or execution cycles. At one to two percent of GDP in total, donor support is important but less determinant of PFM system capacity than in smaller countries.

ASSESSMENT OF THE IMPACT OF PFM WEAKNESSES

9. **PFM systems have three objectives: macrofiscal discipline, strategic allocation of resources, and operational or technical efficiency**. Stepping back from the detailed assessment of the PFM system, it is important to relate the findings to these three objectives to better assess relative risk.

10. **Ukraine has in place the fundamental PFM systems for managing macrofiscal developments, some elements for enabling strategic allocation of resources, and a few tools for improving operational efficiency**. This reflects the

relative emphasis in reforms over the past few years that put in place the treasury and improved budget processes. Second generation reforms are beginning to grapple with better strategic allocation of resources, and even some issues of operational efficiency and accountability. Recent procurement law changes appear to have setback efforts to improve efficient and accountable use of public resources.

11. **Macrofiscal Discipline**. Ukraine has an effective overall PFM control structure in place that can manage total spending and revenues to the budget. The MoF and Treasury have the tools to manage the overall fiscal situation. Reporting formats and quality can be improved to be more comprehensive and user friendly, particularly with tax and customs, but a new PFM modernization project should address this. Within revenue administration, tax and customs revenue forecasting and collection variations are cause for concern and might threaten aggregate fiscal discipline by leading to unexpected revenue shortfalls. Weak taxpayer registries and enforcement tools limit Government's ability to improve revenue administration. While the budget and reporting are quite comprehensive, absence of an automated commitment control system (under implementation) and inconsistent integration of pension financial reports into the consolidated reports (pensions spending is nearly 10 percent of GDP) are gaps. Absence of a clear and coherent governance and oversight framework for state-owned enterprises is a major gap posing significant risk to state debt and expenditure management. Absence of a medium-term expenditure framework, integrating Cabinet of Ministers (CoM) targeted programs, capital spending, and recurrent spending into a coherent macrofiscal framework, poses a risk to overall discipline as well. Introduction of new financial arrangements in capital budgeting, such as public-private partnerships, in the absence of sound multi-year estimation and project costing poses a significant risk to expenditure discipline. In the medium term, the weaknesses in internal audit, external audit, and limited legislative oversight risk pose risks to the integrity of financial information and absence of sufficient automatic feedback on PFM system performance that could help avoid financial crises.

12. **Strategic Resource Allocation.** Some of the rudimentary tools for targeting spending to government priorities are in place, such as Cabinet involvement in setting June budget guidelines, targeted programs, and a program-based budget. The major barrier to more strategic use of resources are absence of a medium-term framework and sector strategies to integrate the other tools already in place. Sound reporting in alignment with the program and other classifications is an essential element for accountability, and while the basic system is in place, improved reporting formats with comprehensive information for in-year and year-end reports would enhance the policy orientation of PFM.

13. **Operational Efficiency**. Some of the tools are in place for better operational efficiency, such as a comprehensive treasury system for controlling and reporting spending (especially with improved commitment controls being implemented), and a program-based classification with performance indicators. Absence of a multi-year framework and sector strategies, and hard sector ceilings in annual budgeting, limit pressure for improved efficiency. Recent changes to the procurement law may significantly increase cost and reduce the quality and quantity of goods and services

purchased by the government, and serve to undermine operational efficiency and government achievement of sectoral objectives. Poor capital budgeting completion rates prevent improvements in operational efficiency from these inputs. External audit below international standards and under-developed internal audits do not allow these functions to add full value for operational improvements. Absence of more in-depth legislative scrutiny does not contribute to pressure for improved efficiency.

Prospects for Reform

14. **Interest in PFM reforms has been strong from the late 1990's through early 2006.** Support for reform has grown from technical staff in MoF to include both technical and high-level policy officials. The broad-based interest reflects ongoing country interest in reach international standards, Minister of Finance commitment to a stronger MoF and PFM system, mid-level MoF interest in addressing internal management challenges, and strong modernization interests from some key organizations (KRU, Treasury).

15. **The PFM modernization working group, led by MoF deputy ministers and involving the Treasurer and MoF departmental heads, has been a good vehicle for planning and advancing the reform agenda**. MoF is working on formally establishing the group as an inter-ministerial working group under Cabinet of Ministers remit, which would strengthen momentum for reform.

16. **The March 2006 parliamentary election produced a new government in August 2006, and early indications are for continued reform.** The MoF working Group is still operational, and plans for Cabinet of Ministers approval of the PFM modernization strategy submission to cabinet are underway.

17. **As with other aspects of the PFM system in Ukraine, the tools are in place for significant progress in PFM system performance** (e.g., the modernization working group and draft strategic reform plans). The major determinant of continued progress will be the interest of new policy officials and their involvement in reform efforts.

1. INTRODUCTION

A. OBJECTIVES

1.1 This Public Financial Management Performance Report (PFMPR) is intended to provide an overall view of public financial management system performance for the Ministry of Finance (MoF) of Ukraine, and serve as an input into MoF development of a White Paper on Public Finance Reform. The White Paper is a strategy for reform, setting out the directions and areas for attention over the next few years.

1.2 The PFMPR is also intended to provide a baseline assessment against which future PFM system improvements can be measured. Ukraine has implemented significant reforms in recent years, with more planned. It will be important for Ukraine to be able to document the reforms and share these widely.

B. PROCESS

1.3 This PFMPR was prepared during 2005 and early 2006 over the course of detailed PFM assistance to the MoF, including advisory work on the white paper on Public Internal Financial Control, MoF reorganization, ongoing Tax Modernization Program, and development of a World Bank Public Financial Management Modernization Project. During the course of this World Bank assistance, sufficient information was gathered to enable report preparation. During some of the numerous meetings with government, specific issues (indicators) in the report where discussed.

1.4 In the fall of 2005, the World Bank translated the PFM Performance Framework (PEFA indicators) into Ukrainian, and transmitted them to the MoF. In discussions with the MoF, the Ministry suggested the World Bank to take the lead in preparing a draft report for discussion with Government.

1.5 The Bank has also actively sought to support MoF leadership improve donor coordination in PFM reforms. Many international organizations, bilateral aid agencies, and international financial institutions (IFIs) are active in supporting PFM reform in Ukraine. During some coordination meetings, the PFMPR was raised and involvement sought. While many expressed interest in reviewing and commenting on the report, there were expressions of interest for direct involvement. Moreover, given that there was no specific mission scheduled for preparing the report (as information was gathered in the course of other work with Government), getting direct involvement from other partners in report preparation was not practicable.

1.6 At MoF's suggestion, the draft report was primarily an external undertaking led by the World Bank with Government collaboration. This draft is intended to serve as the basis of a dialogue with Government and other donors on PFM reform. The intent is also to publish this report once comments have been received and a revised document prepared.

C. METHODOLOGY

1.7 The methodology for PFMPR preparation proceeded as follows:

- Collect and review existing primary information (laws) and reports (Government or donor) on Ukraine's PFM system (see References);
- Gather additional information during various missions and meetings; and
- Submit for Government comment and also to other donors and assistance providers for review and comment.

D. SCOPE

1.8 This PFMPR is focused on the central government. In Ukraine, 30 percent of consolidated Government expenditure occurs at the subnational level (see Table 1.1). The Government is in the process of developing a territorial reform program that will further devolve responsibilities and spending to subnational government.

1.9 Despite the large and growing subnational spending (average annual increase of 22 percent from 2002-04), the objective of the present assessment is to provide input on central government PFM reform. In future, it will be important to use a framework such as PEFA with subnational governments.

Table 1.1: Ukraine's Administrative Architecture

Institutions	Number of Entities	2004 Expenditures (hryvnia millions)	% of total 2004 public expenditures
Central government*	Parliament, Presidency, Cabinet of Ministers, Supreme Court 19 Ministries (Internal Affairs; Foreign Affairs; Coal Industry; Culture and Tourism; Defence; Economy; Education and Science; Fuel and Energy; Labor and Social Policy; Building, Architecture and Housing and Communal Services; Health; Agrarian Policy; Industrial Policy; Environmental Protection; Transport and Communications; Emergencies & Affairs of Population Protection from Consequences of Chornobyl Catastrophe; Family, Youth and Sport; Finance; Justice) 14 State Committees (e.g. Pension Fund, though included below) 19 central authorities with special status (e.g. State Statistical Committee) and 22 other central authorities and bodies (e.g. Central Administration of Registration and Licensing)	55,474	41.2
Autonomous government agencies	4 (Pension Fund; Social Insurance Fund for Temporary Disability; National Labor Accident and Occupational Disability Insurance Fund; National Compulsory Unemployment Social Insurance Fund)	38,806	28.9
Subnational governments	27 Oblast (24 provincial + Republican Budget of Crimea Republic, budgets of Kyiv and Sevastopol cities) 488 rayon (district) budgets and 174 municipal budgets 12,121 local budgets	40,357	30.0
Total		**134,637**	**100**

* Includes ministries, departments, and deconcentrated entities.

Source: Ukraine Statistical Appendix. IMF Country Report No. 05/417. November 2005.

2. COUNTRY BACKGROUND

A. CONTEXT AND ECONOMIC SITUATION

2.1 Ukraine is an eastern European country with a population of approximately 46.7 million (July 2006 estimate). While transition from the socialist tradition began over a decade ago, and much progress has been made in transitioning to a market economy, there are many remnants of the previous approach and apparatus in place and transition is still in progress.

2.2 **Through 2004, Ukraine's growth performance has been strong.** Ukraine's 2004 nominal GDP was US$65.0 billion. Gross national income per capita in 2004 was US$1,260. GDP growth totaled 50 percent for the period 1999 through 2004. At 12.1 percent in 2004, Ukraine's growth was the highest in Europe.

2.3 **Growth had been increasingly broad-based**. Industry played the leading role during 1999-2004 when industrial production grew by 87 percent. Improved financial discipline, substantial real depreciation of the hryvnia to western currencies in 1998-99, more prudent fiscal and monetary policies that followed the real depreciation, and improvement of the business climate—all contributed to igniting Ukraine's economic growth after the 1998 regional financial crisis. Agriculture, agro-processing, chemical manufacturing, and retail trade were also early growth leaders. Table 2.1 below displays recent key macroeconomic indicators.[1]

Table 2.1: Main Macroeconomic Indicators, 1999-2005

	1999	2000	2001	2002	2003	2004	2005
Real GDP (change in percent)	-0.2	5.9	9.2	5.2	9.6	12.1	2.6
Real Industrial Production (change in percent)	4	12.4	14.2	7	15.8	12.5	3.1
CPI, a.o.p. (change in percent)	22.7	28.2	12	0.8	5.2	9	13.5
CPI, e.o.p. (change in percent)	19.2	25.8	6.1	-0.6	8.2	12.3	10.4
Real Exchange Rate, a.o.p. (change in percent, a decline means depreciation)	-2.7	-6.3	0.4	-5.2	-8.9	-5.7	15.3
Current Account Balance (percent of GDP)	5.2	4.7	3.7	7.5	5.8	11.0	--
Foreign Exchange Reserves (USD billions)	1.1	1.5	3.1	4.4	6.9	9.5	19.4
Fiscal Balance (percent of GDP)	-2.4	-1.3	-1.6	0.5	-0.9	-4.4	2.8
PPG Debt and Arrears (percent of GDP)	66.7	47	38.6	35.7	30.0	25.1	19.1
Memo:							
Nominal GDP (in billions of USD)	31.6	31.3	38	42.4	50.1	64.9	81.7
GNI per capita (USD, Atlas method)	760	690	720	780	970	1,260	--
Source: SSC, NBU, IMF, WB							

Source: Implementation Completion Report on Second Programmatic Adjustment Loan, World Bank, April 2006.

[1] Program document for a proposed First Development Policy Loan in the amount equal to US$251.26 million to Ukraine, IBRD, May 24, 2005.

2.4 **Generally, fiscal policy had been prudent**. Primary surpluses of 0-2 percent of GDP during 1999-2003, and some debt restructuring in the wake of the 1998 crisis, reduced the public and publicly guaranteed (PPG) debt ratio (incl. IMF credit) from 67 percent of GDP in 1999 to 30 percent of GDP in 2003. Despite an increase in the budget deficit, the debt ratio further declined to 25 percent of GDP in 2004.

2.5 **Despite the improvements in many economic indicators, a number of economic imbalances began to appear in the second half of 2004**. Domestic inflationary pressures increased, with 2004 consumer inflation exceeding 12 percent and the producer price index growing by 24 percent. Inter-generational tensions led to significant increases in current spending in September 2004, when the government increased pensions by 70 percent on average (adding about 3 percent of GDP to recurrent spending). The transition from an insider economy to greater openness and transparency is still in progress, with production and wealth generation dominated by a few influential financial industrial groups that have thrived in a nontransparent business climate, discouraging foreign direct investment as well as foreign equity participation in Ukrainian enterprises. Regional growth imbalances have developed, with western Ukraine experiencing slower growth and higher levels of poverty than eastern Ukraine. Resource rich Eastern regions experienced wealth generation from a depreciating exchange rate, the export boom, and limited competition in its main exporting sectors.

2.6 **High growth enabled Ukraine to lower poverty incidence**, which declined from above 30 percent in 1999-2001 to 19 percent in 2003. The profile of the poor in Ukraine has changed dramatically since 1999. In 1999 about 36 percent of the poor lived in large cities, 35 percent in rural areas, and just less then 30 percent in small towns. By 2003 almost half of the poor lived in rural areas and still roughly 30 percent in small towns. Forty-two percent of the poor are children.

2.7 **The geographic distribution of public resources and services is adapting more slowly than the demographic changes, reducing public service quantity and quality.** The education budget in Ukraine, for example, is largely determined by the number of students, whereas actual expenditure requirements are a function of the number of teachers. In rural areas, the number of students is declining relatively sharply but the decline in the number of teachers is gradual. As a result, budgets for teaching materials have been squeezed and education quality has suffered. In health, public expenditures per capita are lower in rural areas since allocations to regions and providers of services are generally based on beds and numbers of staff. The use of input criteria has created incentives to overspend on beds and salaries relative to equipment, supplies, and pharmaceuticals. Education and health systems need to be transformed in the context of a stable and working system of local government finance and accountability, in which incentives are aligned with delivery of better services.

2.8 **In 2005, despite slower growth and remaining vulnerabilities, the macroeconomic and fiscal dynamics have been satisfactory**. On the one hand, a forecasted slowdown has been more pronounced than expected, while inflationary pressures remain significant. In particular, GDP growth has decelerated to 2.4 percent

year-on-year in 2005. A large portion of the slowdown is an objective cyclical downturn, anchored in the roots of growth generated since 1999.

2.9 **Cutbacks in public investment accompanied by continuing uncertainty in political environment have caused a substantial fall in investment demand**. The contribution of net exports has declined due to Ukraine's deteriorating ability to benefit from world commodity markets and real appreciation of hryvnia. The terms of trade facing Ukraine, on a trade weighted basis, increased by 24 percent between 2000 and 2004, but are already starting to move relatively against Ukraine. Consumption growth, fuelled by fiscal stimulus, has remained strong.

2.10 **The 2005 budget, amended in March, reduced the targeted consolidated deficit** from implicit deficit of 6.8 percent to 2.2 percent of GDP. It eliminated most remaining tax privileges, tax compliance and enforcement were improved, so that tax revenues were up by 5.6 percent of GDP from January to November 2005, year-on-year. Public debt continues on a declining path, now below 20 percent of GDP. Socially-oriented fiscal expenditures helped to boost households' incomes, which grew by 20.1 percent during 2005 in real terms.

2.11 **The 2005 amended budget significantly increased pension benefits and the minimum public wage**. As a result, the Pension Fund of Ukraine went from a small surplus to an annual deficit of about 3.5 percent of GDP. Overall public expenditures increased by roughly 5 percent of GDP as compared to 2004. However, as mentioned above these were financed through elimination of most remaining tax privileges, improvements in tax compliance and enforcement, and a perceived reduction of the shadow economy (not tax rate increases, nor introduction of new taxes). Inflation peaked at 14.9 percent year-over-year in August 2005 and fell to 9.8 percent year-over-year in January 2006.

B. Overall Government Reform Program

2.12 **March 2006 parliamentary election led to a new government in August 2006 under Prime Minister Yanukovych.** The new government is still forming and policy directions and reform initiatives have yet to be announced. PFM reform is expected to continue as a priority under the new government.

C. PFM Reform Rationale

2.13 **At a technical level, PFM reforms have been underway in Ukraine since the transition with significant progress made**. The Government interest in harmonizing with international standards has given a renewed impetus to reform across the entire PFM system. At a technical level, there is also a realization of shortcomings in the current PFM system that needs to be remedied to improve public sector performance. This manifests itself in the current MoF effort to draft a PFM reform strategy. Improvements in PFM—and public sector writ large—performance are critical to fulfill national objectives.

D. BUDGETARY OUTCOMES

Fiscal Performance

Table 2.1: Central Government Budget
(% GDP)

	2002	2003	2004	2005
Total revenue	20.1	20.6	20.4	25.1
- Own revenue	18.7	19.6	19.6	24.7
- Grants	1.4	1.0	0.8	0.4
Total expenditure	19.6	21.0	23.0	27.0
- Non-interest expenditure	*18.4*	*20.0*	*22.1*	*26.2*
- Interest expenditure	*1.2*	*0.9*	*0.9*	*0.8*
Aggregate deficit (incl. grants)	0.5	-0.4	-2.6	-1.8
Primary deficit	1.7	0.6	-1.8	-1.0
Net financing	-0.5	0.4	3.1	1.9
- external	-0.6	0.1	0.2	0.2
- domestic	0.1	0.1	2.9	1.7
Total	100.0	100.0	100.0	100.0

Allocation of Resources

Table 2.2: Actual Budgetary Allocations by Sectors
(% total expenditures)

Expenditure Item	**2002**	**2003**	**2004**	**2005**
General functions of public administration	16	14	12	11
Defence	8	9	8	5
Civil order, security and courts	11	10	10	9
Economic activities	13	16	18	12
Agriculture, forestry, fishery, hunting	3	5	4	4
Energy fuel complex	5	6	6	3
Protection environment	1	1	1	1
Housing communal economy	0	0	0	0
Health care	4	4	4	3
Spiritual and physical development	1	1	1	1
Education	11	10	9	9
Social protection and insurance	16	12	15	28
Interbudgetary transfers	20	21	21	21
Total	100	100	100	100

Table 2.3: Actual Budgetary Allocations by Economic Classification
(% total expenditure)

Expenditure Item	**2002**	**2003**	**2004**	**2005**
Current expenditures	91	87	81	90
- Wages and salaries	20	20	*18*	14
- Goods and services	23	24	*19*	19
- Interest payments	6	4	*4*	3
- Transfers	42	39	*40*	54
Capital expenditures	10	12	19	10
Total	100	100	100	100

E. LEGAL AND INSTITUTIONAL FRAMEWORK FOR PFM

2.14 **Ukraine PFM roles and responsibilities are clearly defined and assigned.** Ukrainian public administration emphasizes clear definition and assignment of roles and tasks for state administrative bodies, and this is true for PFM. The key actors and their major tasks are summarized in Table 2.4.

Table 2.4: Central PFM Organizations and Roles in Ukraine

Organization	Major Tasks	Comments
Ministry of Finance	o Budget Formulation and Execution o Debt Management o Revenue Policy o Treasury	o Includes some responsibility for economic and fiscal forecasting o Debt Market Development function not developed o Cash Management function not developed
Control and Revision Service (KRU)	o Internal Inspection Servicet	o Centralized, government-wide internal inspection service, focusing on compliance, but actively modernizing. Each ministry also has an internal inspection unit. o Under MoF purview, but with independent status to enable auditing of MoF.
State Tax Administration	o Tax collection	o Nominally under MoF purview o STA administers tax policy, while MoF sets policy
Customs Administration	o Customs enforcement and collection	o Nominally under MoF purview o Customs administers customs laws, while MoF sets revenue policy
Ministry of Economy	o Macroeconomic forecasting o National Economic Policy o Multi-year planning o Developing targeted programs list for CoM o Capital Project Selection o (Procurement) o SOE efficiency review	o Multi-year planning underdeveloped, not well integrated into budget process o MoF sets overall ceilings for ministries, including indicative capital/recurrent levels o Until 2006, procurement was assigned to MoE. Recent Rada legislation re-assigns the task to a non-governmental central executive body with special status in the Ukrainian administrative system. o SOE review not developed
Accounting Chamber	o External Audit	o Supreme Audit Institution o Mandate recently expanded to enable auditing of revenues, and SOE's

2.15 **Other organizations also have important PFM roles, but more narrow in scope.** For example, the State Statistical Committee has an important role in fiscal data collection and dissemination. The State Property Fund is responsible for management oversight of some SOE's.

2.16 **Some PFM functions are evolving and may increase the importance of some actors in PFM**. For example, recent procurement law changes have assigned important procurement oversight and administration tasks to a nongovernmental central executive body with special status in the Ukrainian administrative structure and its affiliated company. If implemented, the Tender Chamber of Ukraine (nongovernmental central executive body) and Accounting Chamber (given approval authority over some procurements even though a legislative branch body) will become important actors in the Ukrainian PFM system.

2.17 **Spending ministries have a critical role in PFM, but relatively less attention has been given to improving their capacity to carry out their PFM responsibilities**. Spending ministry tasks include strategic and multi-year planning, budget formulation, capital project preparation and management, budget management, procurement, asset management, SOE oversight, and internal inspections and internal controls. Many of these tasks remain undeveloped at line ministries, and these will require significant attention in future if PFM is to achieve its objectives. Recent problems in underexecution of capital spending and increasing numbers of incomplete projects arise from some central budget execution practices, but also from limited capacity and nonrational incentives in ministries (for example, during budget formulation, more capital funds are allocated to ministries with a higher proportion of incomplete projects, providing an incentive for ministries to increase the number of incomplete projects) .

2.18 **While central PFM roles are clearly defined and assigned, the tasks have been assigned without consideration of a coherent PFM system**. Some functions are fragmented among several actors. Coordination across actors has posed problems. Some tasks, while assigned, have not been fully developed. And capacity to fulfill assigned tasks varies among actors. For example, coordination on macroeconomic forecasting, medium-term planning and budgeting, and capital budgeting are split between MoF and MoE. SOE oversight is split among many actors, including CoM, State Property Fund, MoE, and individual ministries.

2.19 **The Government has taken steps to resolve some PFM function fragmentation**. An April 2005 Presidential Decree (Presidential Decree Number 676 of April 20, 2005) reorganized Treasury as a government agency under the MoF and gave the Minister of Finance authority to direct and coordinate the State Tax Administration, Customs, and KRU. Moreover, a PFM reform strategy is currently under development in the MoF, and a PFM modernization project is in development by MoF, Treasury and KRU jointly with the World Bank.

2.20 **The annual budget process is well defined, with a clear calendar** (see Table 2.5).

Table 2.5: Ukraine Annual Budget Calendar

March/April	Preliminary macroeconomic forecast by MOE, NBU, and MOF in consultation, and estimate of revenue by MOF
April/May	Expenditure limits set for key spending units.
May 29	Budget policy guidelines sent to Rada[2]
June 1	Commencement of hearings on budget policy in the Rada
Early June	Expenditure guidelines and request for expenditure estimates issued by the MOF.
End-June	Estimates of recurrent and capital needs prepared by key spending units (and their subordinate units) in accordance with schedule set by MOF.
August 15	Other laws that affect budget revenues or expenditures must be enacted before August 15 of the year that precedes the planned year.
Mid-August	Consolidated state budget prepared by MOF and submitted to government.
September 15	Revised budget approved by government and submitted to Rada. Within five days after government approval, the Minister of Finance presents the budget to a plenary session of the Rada, accompanied by a report from the Budget Committee on compliance with the budget code and the policy guidelines—noncompliance could result in resubmission.
October 1 or 6	Rada: first reading, no later than October 1 (or October 6 if a second submission by government required).
November 3 or 8	Rada: second reading no later than November 3 (or 8).
November 25	Rada: third reading no later than November 25. Should the budget law not be adopted, monthly state budget expenditures will be restricted to 1/12 of the monthly amount applied under the previous year's budget.
December 1	Rada: adoption of the State Budget Law.
December	Regional and local authorities: approval of budgets taking into account transfers and other provisions approved by the Rada
Based in part on *Ukraine: Report on the Observance of Standards and Codes:Fiscal Transparency Module,* IMF Country Report No. 04/98, page 23, April 2004.	

2.21 **The legislative underpinnings for PFM in Ukraine are generally sound, but fragmented across primary (statutes) and secondary (regulations and decrees) legislation**. The key primary documents include:

- The Constitution of Ukraine
- The Budget Code of Ukraine (2001)
- State Auditing Service Law – governing Accounting Chamber tasks
- The Law of Ukraine On The State Control and Revision Service (2003) – internal audit functions

[2] Article 33 (3) (5) of the 2001 Ukrainian Budget Code requires the budget guidelines to include "capital expenditures as a share of State budget expenditures and high-priority purposes for the use of capital expenditures".

- Treasury Law – defining treasury functions, but modified by the Presidential decree merging Treasury with MoF
- The Procurement Law of Ukraine
- Law of Ukraine on the State Tax Service of Ukraine
- Law of Ukraine on the System of Taxation
- Law on the Procedure of Repayment of Liabilities of Taxpayers to Budgets and State Special-Purpose Funds.

2.22 Important secondary legislation includes:

- Cabinet of Ministers Decree On the Concept of Development of the Government Internal Financial Control and Audit System in Ukraine (2005)
- Cabinet of Ministers Regulation # 631 On Elaboration of Projected and Program Documents for Economic and Social Development and Drawing up Draft of State Budget (April 2003, as amended through CMU Regulation No. 165 dated February 11, 2004)
- The Decree by the President of Ukraine On the State Treasury of Ukraine
- The Cabinet of Ministers Regulation On the Mandate of the State Treasury of Ukraine
- Presidential Decree No. 676 of April 20, 2005 entitled, "On the Issues of the Finance Ministry of Ukraine"
- Cabinet of Ministers Order #995 on Delegation of Decision-Making Authority over Capital Spending (1997).

2.23 The PFM legal framework is evolving, and some areas have active pending legislation or policy in development, including subnational borrowing, territorial reform (subnational), and tax administration.

3. PFM ASSESSMENT

A. CREDIBILITY OF THE BUDGET

	PFM Out-Turns: Credibility of the Budget	
PI-1	Aggregate expenditure out-turn compared to original approved budget	**B**
PI-2	Composition of expenditure out-turn compared to original approved budget	**B**
PI-3	Aggregate revenue out-turn compared to original approved budget	**A**
PI-4	Stock and monitoring of expenditure payment arrears	**B+**

3.1 **The credibility of the budget—whether it can be trusted as a reliable statement of government intentions and is a substantive plan of action—matters to a whole range of stakeholders**, including citizens, investors, and not least budget users who will implement the budget and deliver the goods and services. Budget deviation—the difference between the original approved budget and actual expenditures—is a good measure of the overall performance of the PFM system, spanning the quality of budget formulation through execution (both aggregate management, as well as program management).

3.2 **In Ukraine, aggregate expenditure out-turn varies somewhat from the approved budget**. Aggregate expenditure varied by -11 percent in 2002, 0.4 percent in 2003, +10 percent in 2004, and -6 percent in 2005. While the swings are not as large as seen in some countries, they are larger than the economic skills and institutional capacity available in Ukraine would predict. Table 3.1 presents the aggregate spending and functional classification outturns from 2001 through 2005.

Table 3.1: Central Government Budget Execution, 2001-2005
(UAH Million)

Expenditure Item	2002			2003			2004			2005		
	Aprvd	Exec	Wtd Ave	Aprvd	Exec	Wtd Ave	Aprvd	Exec	Wtd Ave	Aprvd	Exec	Wtd Ave
General admin	8,945	6,872	0.04	8,429	7,863	1%	10,191	9,634	1%	12,526	11,981	0%
Defence	4,100	3,536	0.01	5,059	5,280	0%	5,991	6,186	0%	6,199	6,041	0%
Civil order, security and courts	4,272	4,677	0.01	5,225	5,705	1%	7,273	7,705	1%	10,457	10,123	0%
Economic activities	8,117	5,581	0.05	9,883	9,187	1%	12,023	14,242	3%	15,269	14,034	1%
Agriculture, forestry, fishery, hunting	1,637	1,368	0.01	2,816	2,772	0%	3,171	2,927	0%	5,222	4,891	0%
Energy fuel complex	2,686	2,181	0.01	3,651	3,262	1%	4,462	4,464	0%	4,238	3,784	0%
Protection environment	721	528	0.00	702	726	0%	905	896	0%	1,082	980	0%
Housing communal economy	67	51	0.00	70	83	0%	237	107	0%	123	110	0%
Health care	2,088	1,582	0.01	2,215	2,352	0%	3,212	3,435	0%	3,736	3,497	0%
Spiritual and physical devt	616	425	0.00	652	645	0%	1,064	1,004	0%	1,368	1,274	0%

Expenditure Item	2002			2003			2004			2005		
Education	4,690	4,989	0.01	5,567	5,736	0%	6,984	7,197	0%	10,505	9,882	1%
Social protection and insurance	6,919	7,273	0.01	6,752	6,816	0%	8,438	12,157	5%	32,600	31,548	1%
Interbudgetary transfers	9,039	8,814	0.00	11,354	11,729	1%	15,877	16,787	1%	25,629	23,361	2%
Aggregate Variation (weighted ave)	-	-	16%	-	-	6%	-	-	12%	-	-	6%
TOTAL	**49,574**	**44,330**	**11%**	**55,908**	**56,120**	**0%**	**72,297**	**79,3849**	**10%**	**119,493**	**112,831**	**6%**

3.3 **In many countries, one root cause of budget deviation is the overly optimistic macroeconomic and revenue forecast used to develop the budget.** In Ukraine, subsequent to the budget, the National Bank, MoF, and MoE meet to develop a technical consensus forecast that is published—but that forecast is not used in budget development. By not using sound forecasts, the credibility of the budget could be undermined from the beginning.

3.4 **In Ukraine, recent macroeconomic forecasting used to develop the budget has been reasonable and conservative. While macroeconomic forecasting can be strengthened, it is not the root cause of the expenditure variability**. Table 3.2 below shows the GDP growth forecast used for budget development, the subsequent consensus forecast, and actual economic growth for 2002-2005.

Table 3.2: GDP Growth, 2002-2005
(in percent)

	2002	2003	2004	2005
Budget Economic Growth Forecast	6.0	4.0	4.8	8.2
Consensus Forecast	6.2	4.4	5.5	7.7
Actual GDP Growth	5.2	9.6	12.1	2.6

3.5 **In many countries, budget credibility is also undermined by significant variation between the composition of spending in the original budget and actual spending composition.** Government policies as contained in the original budget are undermined through weak budget execution rules or irregular cash management practices. The composition variation is a concern where the weighted average of expenditure items (functional or administrative basis) exceeds the aggregate variation, suggesting re-allocation across priorities.

3.6 **In Ukraine, compositional variation is minimal, and generally follows the original budget.** Table 3.1 also shows the weighted average deviation of functional categories. While there have been in-year modifications, these have followed the priorities of the original budget closely. In-year spending adjustments generally favored internal security, justice, health, education, and social protection. (See accompanying text box on recent patterns of protected programs.)

3.7 **In Ukraine, the underlying rules-based spending protection mechanism is clearly working**. The Budget Code allows for annual identification of programs to be protected from in-year adjustments.[3] Annual budgets have included lists of protected programs, and the actual pattern of spending match closely these protected programs. For example, the 2006 Budget identifies protected expenditure items and activities as: personnel wages/ salaries; payroll taxes/duties; procurement of medications and bandaging materials; payment of utility services; interest on the national debt; transfers to the population; transfers to local budgets; and many military activities.[4, 5]

Revealed Preferences: Favored Programs in Budget Execution

Actual spending can reveal the actual policy preferences of governments across sectors. For Ukraine, the patterns are consistent, and match the ex ante protected programs identified in annual budget laws.

- In 2002, during a period of retrenchment, most functional areas received less than the original budget, but some received more. Areas receiving more than the original budget included civil order, security and courts (+9%), Education (+6%), and social protection and insurance (+5%).
- In 2003, a year when the budget was nearly brought in as approved, again saw several functions received more than the original budget and many less. Those receiving more than originally approved included defense (+4%), civil order, security and courts (+9%), Health (+6%), Education (+3%), and social protection and insurance (+1%).
- In 2004, a year of expenditure above the approved budget, the favored functions changed slightly, and included defense (+3 %), civil order, security and courts (+6%), Economic activities (+18%), Health (+7%), Education (+3%), and social protection and insurance (+44%). Notably, in 2002 and 2003, Economic Activities received significantly less than the approved budget (-31% and – 7%, respectively).
- In 2005, a year of under spending the original budget, all functional areas were reduced, with defense, civil order, security and courts, and social protection and insurance receiving the least proportional reduction (3%). Economic activities (-8%), Environment (-9%), housing (-11%), and interbudgetary transfers (-9%) bearing the brunt of the reduction.

3.8 **In many countries, revenue forecasts or collection volatility undermine budget credibility.** Weak revenue forecasts, inclusion of unrealistic new revenue plans, or weak revenue collection systems necessitate budget revisions during budget implementation.

3.9 **In Ukraine, aggregate central government revenues have been quite close to the original budget levels.** For the past three fiscal years, aggregate central government

[3] Article 55, Budget Code of Ukraine 2001.

[4] Article 32, State Budget of Ukraine for 2006.

[5] The full list is: Wages/salaries to the personnel of budget spending units (code 1110); payroll taxes/ duties (code 1120); procurement of medications and bandaging materials (code 1132); provision of food products (code 1133); payment of utility services and sources of energy (code 1160); payment of interest on the national debt (code 1200); pransfers to the population (code 1340); and pransfers to local budgets (code 1320). In addition, the following are identified as protected activities: construction (procurement) of the housing for the military personnel; reforming and development of the Armed Forces of Ukraine; intelligence activity; provision of durability and explosion/fire safety of the arsenals, bases, and depots of weapons, missiles and ammunition of the Armed Forces of Ukraine; disposal of conventional ammunition that cannot be stored or used; provision of the disabled with orthopaedic, movement, and rehabilitation devices (equipment); training of personnel in the institutions of higher education of accreditation levels I-IV; fundamental and applied research, as well as design and development activities.

revenue has averaged 98.5 percent of budget forecast. Table 3.3 presents aggregate and composition of revenue estimates versus actual collections for 2004-2005.

3.10 **The high degree of aggregate central government revenue credibility does mask some larger variation in the composition of revenue between the budget and actual revenues.** Tax revenues have been very close to plan in aggregate, while nontax revenues have been overestimated by roughly 10 percent on average. Within tax revenues, enterprise profits tax tend to be underestimated, while VAT and import excise taxes tend to be overestimated (see Table 3.3 for details by year). Further work on the reasons for the variation between estimates and actual collections is warranted.

Table 3.3: Central Government Revenues, 2002-2005
(million UAH)

	2002			2003			2004			2005		
	Actual	Plan	% of Plan	Actual	Plan	% of Plan	Actual	Plan	% of Plan	Actual	Plan	% of Plan
Tax Revenues	**28935**	**29857**	97	**35726**	**34562**	103	**44853.5**	**44371.1**	101	**74476.4**	**74915.5**	99
Personal Income Tax	0	0	-	0	0	-	634.5	752.1	84	838.6	759.6	110
Enterprise Profit Tax	8162	10214	80	13087	11708	112	16025.3	12606.8	127	23272.2	22276.1	104
Value Added Tax	13471	12888	105	12598	13652	92	16733.5	19843.8	84	33803.8	33450.9	101
Excises on Domestic Goods	3394	2762	123	4554	4367	104	6047.8	5934.7	102	7283	7483.6	97
Excises on Imported Goods	493	676	73	587	553	106	612.8	808.1	76	598.9	911.8	66
Non-tax Revenues	**12625**	**14141**	89	**15791**	**17659**	89	**22373.7**	**23169**	97	**28098.1**	**30816**	91
Total	**42525**	**45202**	94	**52708**	**53441**	99	**68736.9**	**68994.1**	100	**103728.8**	**106831**	97
Official Transfers	292	292	100	2369	2383	99	1593.2	1590.9	100	1463.1	1322.8	111
Total Revenues	**45468**	**48293**	94	**55077**	**55824**	99	**70330.1**	**70585**	100	**105191.9**	**108153.8**	97

3.11 **Payment arrears—unpaid bills—is another good bellweather of how well the overall PFM system is performing, encompassing both technical system issues as well as management of public finances.** The existence of large stocks of arrears, or increasing or steady stock of arrears, is indicative of underlying system or policy problems that need to be explored. Cash triage at invoice stage is frequently undertaken to match revenues and expenditures in the immediate term (one to two weeks), but can undermine budget priorities (generating arrears in priority sectors while nonpriority sector invoices are paid).

3.12 **In Ukraine, budget payment arrears appear in control at 0.5 percent of 2004 consolidated spending.** The stock of payment arrears has generally declined over the past few years, from a high of 2.7 percent of consolidated expenditure in 2002.

3.13 **But the current budget execution system does not provide full, ongoing reporting of payables for management purposes, and also poses some systemic risks for arrears generation.** Spending units input some payables information into the

Treasury integrated financial management information system (IFMIS) system, and provide Treasury with monthly reports of payables and receivables. Spending units also provide MoF with a quarterly consolidated report on payables. There are significant discrepancies between regular and consolidated reports, as spending units report only payables they intend to pay rather than all outstanding payables. Beyond reporting problems, the situation also stems from Treasury operating a cash accounting system, while MDA's maintain accrual-based systems. Treasury used 10-day cash warrants through 2006. If Treasury lowered its 10-day cash warrant levels, these only delay invoice payments. An automated commitment registration and control module is being implemented in 2006, which should improve prevention of arrears. In late 2006, the 10-day warrant system was abolished, and protected spending receives a full monthly budget allocation. Future assessments should review how well this is working, and whether the structure poses risks for arrears generation.

3.14 **Overall, in Ukraine the original approved budget is a fairly reliable guide to government policy**. Aggregate expenditures and revenues are close to budget levels, and composition of spending is also close to the original budget levels and in relative priority. The annual process of identifying priorities to be protected during budget execution is working. Payment arrears are low, and have been declining, indicating no major issues.

B. Comprehensiveness and Transparency

	Comprehensiveness and Transparency	
PI-5	Classification of the budget	**A**
PI-6	Comprehensiveness of information included in budget documentation	**A**
PI-7	Extent of unreported government operations	**D+**
PI-8	Transparency of inter-governmental fiscal relations	**B+**
PI-9	Oversight of aggregate fiscal risk from other public sector entities	**D**
PI-10	Public access to key fiscal information	**B**

3.15 **Overall, there is a fair degree of comprehensiveness and transparency in central government public finances**. Administrative, economic, and program classification exist for the national government, generally following GFS standards. This provides a good basis for controlling, monitoring, and reporting on expenditures.[6]

3.16 **A comprehensive set of information is included in the annual budget**, there are few unreported government operations (see below for the key exception of state-owned enterprises), there some degree of transparency in intergovernmental fiscal relations (though the current formula is complicated), and there is generally good public access to key fiscal information.

3.17 **More detail on capital spending could be provided to indicate key trends in spending.** Current aggregate capital spending figures mask important trends, for example

[6] One caveat is the 'development budget' concept, which merges all capital spending with subsidies to enterprises, providing a potential misleading picture of total 'capital' spending. However, even here there are detailed classification codes that allow relatively easy identification of the issue.

that most of the increase in capital spending since 2001 has been in capital subsidies to state-owned enterprises rather than in fixed capital investment.

3.18 **Extrabudgetary fund (EBF) operations are reported.** There are four extra-budgetary funds (pension fund, the social insurance fund for temporary disability, the national labor accident and occupational disability insurance fund, and the national compulsory unemployment social insurance fund), which as of 2004 comprised 11 percent of GDP or 25 percent of consolidated government expenditure. EBF spending is reported, and consolidated with Government financial statements (except pensions, which at 25 percent of spending is not insignificant), though reporting frequency could be improved.[7]

3.19 **Subnational governments operate through the Treasury and cannot expend more than their budget.** Treasury can monitor these and sends regular reports to MoF. MoF has a special department for subnational budget preparation and monitoring. Subnational governments above a certain size may incur debt, but the MoF must approve. Annual financial reports are consolidated national and subnational government reports.

3.20 **Subnational government budget formulation could be more transparent.** While an expenditure equalization formula has been in place since 2001, the adjustment coefficients are modified annually by MoF staff and the rational for changes are not clear. Parallel capital transfer programs operate without clear rules. Overall, an estimated 20-50 percent of annual subnational transfers occur through less than clear procedures.

3.21 **Public access to key fiscal information is generally good.** A complete set of budget documents can be obtained by the public through the MoF and Rada website when submitted to the legislature. Monthly and quarterly financial reports are prepared within 20 days of period end by Treasury, and submitted to MoF, and published monthly within 20 days of period end. Government officials also have on-line access to Treasury database. Year-end and quarterly financial statements are available to the public prior to audit. External audit reports are posted on the Chamber web site, and audit findings are presented to the Rada, media, and public. A positive step is the inclusion of tax-expenditure reports in budget documentation. Inclusion of quasi-fiscal activity estimates would further improve fiscal transparency.

3.22 **Two areas for improvement are procurement contract awards and publication of information on resources received by service delivery units.** The procurement law requires all contract awards to be published within one week. While this was happening, it is not clear what effect the new procurement arrangements will affect reporting (see more under PI-19 below). Resources available to primary service units are available, but are not published as such. Treasury has this information, but it is not actively monitored by MoF or publicly released. It has generally not been viewed as a problem.

[7] While establishment of EBF is prohibited, the 2004 IMF Fiscal Transparency ROSC reports that ministries may establish SOE's to carry our certain state functions. Ministries may thus use SOEs to increase spending flexibility and reduce oversight in Ukraine, whereas in other countries EBFs might be established.

3.23 **The major area of weakness is in reporting, oversight, and monitoring of other public sector entities, namely state-owned enterprises (SOEs).**[8] As of 2005, there were some 5,800 central government owned enterprises in Ukraine under a complex array of status and oversight arrangements: 52 state enterprises with special status (kazenni); 4,000 state-owned enterprises; and 1,711 state-owned corporations.[9] The 4,052 unincorporated SOE's had 7.1 billion hryvnias in revenue in 2001, and held 28 percent of the total working capital of all Ukrainian companies that year.[10]

3.24 **SOE oversight is fragmented**. The State Property Fund has formal managerial responsibility on behalf of government for some SOEs, along with line ministry responsible for individual SOEs. The Ministry of Economy (MoE) has responsibility for evaluating the financial performance of SOEs, but this is not done consistently or thoroughly.[11] SOEs are required to have annual external audits. However, the system is viewed as weak. MoF should be actively monitoring expenditures, but little actual monitoring occurs at present. A 2005 KRU report found some SOE managers engaging in export fraud to maximize VAT receipts. The Accounting Chamber may only audit SOE use of budget funds, and few such reviews have been done to date.

3.25 **SOE debt is not registered and SOEs pose significant contingent liability risk for government**. SOEs may issue debt on domestic or international markets on their own authority without prior government review or approval. SOE debt is not registered and the government is not aware of total outstanding SOE indebtedness. Moreover, there is a significant amount of quasi-fiscal activity undertaken through SOEs, estimated at 6 percent of GDP or equivalent to 22 percent of annual consolidated government spending (mainly in the energy sector, though reportedly declining in recent years).

3.26 **The Government of Ukraine is beginning to recognize SOE risk and take action.** In January 2006, amendments to the state auditing law granted authority to the central internal audit body (KRU) to undertake financial and performance audits of SOEs. KRU is developing methodologies and planning an aggressive work program to audit and strengthen oversight of this sector. While not consistent with the Public Internal Financial Control concept adopted as KRU's long-term goal, the pressing government need to introduce some 'emergency' oversight of this sector necessities the expansion of KRU authority as the only immediate measure available. The Accounting Chamber (SAI) was also given authority over SOEs, but has not previously audited nor is it currently auditing SOEs. Since February 2006, a new Cabinet of Ministers resolution requires

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[8] The SOE problem adversely affects two of the performance indicators: PI-7 on extent of unreported government operations and PI-9 oversight of aggregate fiscal risk from other public sector entities. Absent SOE oversight and reporting, Ukraine would have scored an 'A' on both indicators.

[9] Excludes 14,705 locally-owned SOEs.

[10] Dmitriy Leonov, PhD and Rostyslav Zhuk, Study on Management of State-Owned Enterprises in Ukraine, 2005 (unpublished).

[11] The 2004 IMF Fiscal Transparency ROSC noted that, "Starting in 2002, the MOE has been given the authority to monitor the financial performance of most state enterprises supervised by state executive bodies (Decree of the President No. 216, March 5, 2002, 'On the Measures for Deshadowing the Economy')." It is not clear to what extent this has been implemented, given the frequent reorganizations at MOE.

agencies responsible for SOE management to prepare financial estimates (including borrowing plans) and submit them to the MoE. Report content and date coverage are unclear, and apply only to selected groups of firms. In late 2006, the Cabinet of Ministers instructed the State Property Fund to update its inventory of state assets (including SOEs).

3.27 **Parliament is also concerned and taking some measures.** In addition to changes to the audit law enabling KRU oversight, Article 115 of the 2006 Budget Law states, "Within two months the Cabinet of Ministers of Ukraine shall develop and approve the procedure limiting administrative expenses of business entities in the public sector of economy with respect to the used of official cars, consulting, insurance, and audit services; regulating other operating expenses not related to core business; determining that the procedure and method of doubtful debt provision creation and write-off of doubtful debts of public sector entities shall be specified by a resolution of the authorised management body."

C. POLICY-BASED BUDGETS

	Budget Cycle	
PI-11	Orderliness and participation in the annual budget process	**B+**
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C**

3.28 **The budget process in Ukraine is orderly**, with a well-defined budget calendar that is generally adhered to, enabling significant involvement of elected officials in both the executive and legislative branches of government. Annual budget approval buy the legislature is timely, having been approved before the start of the fiscal year in all but one year since 1998.

3.29 **The quality of the budget formulation process is being improved.** Currently the annual budget discussions between MoF and MDAs are primarily input-based rather than over policy, objectives, and outcomes. Budget discussions tend to be more negotiations over budget shares than competing policies and priorities. The MoF did introduce program budgets in 2002 and is working to improve its use. As of 2004 each program is required to have a performance passport annually, where the next years performance targets and outputs are identified. The passports are signed by the MDA head and Minister of Finance.

3.30 **The current budget process does not have a well-integrated multi-year perspective in fiscal planning**. A 2003 Government regulation[12] does require multi-year economic and social planning, but this task is assigned to the MoE. It is not fully implemented and not integrated with the budget process. Assessments of medium-term fiscal sustainability, while undertaken, can be strengthened. Budget forecasts and ceilings

[12] Cabinet of Ministers of Ukraine Regulation # 621, April 26, 2003, "On Elaboration of Projected and Program Documents for Economic and Social Development and Drawing up Draft of State Budget," (with changes and amendments introduced by CMU Regulation No. 165 dated February 11, 2004).

are one-year only. Capital projects do include multi-year cost estimates, but these are also not incorporated into the one-year budget.

3.31 **Multi-year sector strategies do not exist**, though ministries with large capital expenditures do have multi-year strategies (e.g., transportation). The Government (Cabinet of Ministers) does designate targeted programs annually, reflecting an implicit government-wide strategy of sorts, but these are not costed multi-year or well-integrated into decision-making.

3.32 **The MoF is developing a public financial management reform strategy white paper**. In developing the strategy, attention is being given on how to strengthen the multi-year perspective in budget formulation, and improve capital budget planning and execution.

3.33 The Accounting Chamber's 2004 Annual Report identified cases of overbudgeting (above needs) amounting to 529 million hryvnia (0.7 percent of the 2004 budget total)[13] and expenditures planned without statutory authorization of 132 million hryvnia (0.2 percent 2004 budget total).[14] Given the magnitude of funds involved, this generally supports the conclusion of a reasonable budget process in Ukraine.

3.34 Overall, the Ukrainian annual budget process is orderly, allows ample opportunity for policy official involvement, and is becoming more policy-based. Addition of a more systematic multi-year perspective would further enhance the process. The introduction and refinement of program and performance budgeting, and development of a white paper on PFM reform, indicate an active interest in improving the budget formulation process. Some improved performance is possible with relatively simple improvements, such as further development of the spring budget guidelines into a fiscal policy paper for cabinet and the Rada (with multi-year forecasts), and inclusion of multi-year sector ceilings in the Guidelines.

[13] Given the Accounting Chamber 'audits' one-third of total spending per year, generalizing from their findings to the entire budget would put overbudgeting in the range of 2 percent of the total budget. But the analytic basis or methodology for the Accounting Chambers' judgment is unclear.

[14] It may be a translation issue, but it is not clear if there was actual spending without *statutory authorization* or only proposed spending without approved legislation (e.g., a new program included in the proposed budget accompanied by the legislation to authorize the spending). The latter is common practice internationally, while the former is obviously problematic.

D. BUDGET EXECUTION

	Predictability and Control in Budget Execution	
PI-13	Transparency of taxpayer obligations and liabilities	C
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C
PI-15	Effectiveness in collection of tax payments	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	D+
PI-17	Recording and management of cash balances, debt and guarantees	B
PI-18	Effectiveness of payroll controls	D+
PI-19	Competition, value for money and controls in procurement	D+
PI-20	Effectiveness of internal controls for non-salary expenditure	C+
PI-21	Effectiveness of internal audit	C+

3.35 **Budget execution—the rules and processes for implementing the budget—are critical underpinnings of any PFM system**. Weak execution systems undermine government policy and threaten the central objectives of the PFM system itself (macrofiscal discipline, strategic allocation of resources, and operational efficiency). While sometimes viewed as 'technical plumbing' better left to specialists, adequate high-level attention to the core budget execution systems is a fundamental management role.

3.36 **In Ukraine, the budget execution system is presently characterized by widely varied performance.** Although able to deliver total and compositional spending targets, smaller internal processes inhibit operational efficiency. The mixed results reflect the fragmented nature of the execution system with: (a) no government entity taking overall responsibility or oversight for system operation (e.g., MoF, MoE, ACU); (b) weak coordination or integration of processes spanning organizations (e.g., Treasury-State Tax Service data matching); and (c) uneven modernization of organizations and processes (e.g., Treasury has undergone one modernization and is embarking on a second round, while tax, customs, procurement, and civil service have yet to start).

3.37 **Better assessment scores do appear in areas where modernization has taken place, yielding better system performance**. Indicators where Treasury plays a role, for example, do perform better than areas where no modernization has taken place. The remainder of this section is divided into the component parts: revenue administration (PI 13-15), expenditure administration (PI 16-18, 20), procurement (PI 19), and internal audit (PI 21).

Revenue Administration

3.38 **Effective tax administration entails many factors**, but key among them are transparent rules and processes that make taxpayer obligations clear (making payment easy), effective measures to register taxpayers and assess tax liability (who should pay and how much), and effective collection (the level of outstanding tax liabilities is low).

3.39 **In Ukraine, taxpayer obligations and liabilities are not clear.** The lack of a unified tax code and a single administrative act on tax procedures result in a complex and ambiguous legislative base for tax liabilities and taxpayer compliance. The legacy of a decentralized administrative structure, weak information systems, and limited

skills—combined with the complexity of and ambiguities in the tax legislation—result in substantial variations in the actual determination and enforcement of tax liabilities. Under current procedures, taxpayers submit self-declaration of tax liability to local tax offices, where tax officials adjust liability and then record the liability to the State Tax Service. The basis of the adjustments made by local officials is unclear, and there is no central record of the original self-declaration. Current data exchange between Treasury and STS does not allow either entity to easily match actual payments with indicative tax liability.

3.40 **Ukrainian taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited.** Ukraine has implemented a unified business register, including for taxes. However, the tax administration has weak powers to deny tax registration on the basis of poor compliance histories. This includes for VAT, which creates serious problems for the integrity of the VAT payment chain. Weaknesses in the legislation and in the tax administration's (decentralized) systems also hinder the administration's ability to implement unified taxpayer accounts. This limits the ability of the tax administration to provide an authoritative and comprehensive record of transactions and obligations to the taxpayer. Similar weakness prevent the tax administration from being able to effectively and in a timely manner consolidate tax liabilities and transactions for analysis, internal audit, and for sharing with the other fiscal entities—i.e., the MoF, and the customs administration. The integrity of VAT refund policies has undermined the VAT chain and enterprise cash flow, even as it helped achieve government revenue targets.

3.41 **Taxpayer registration and assessment systems are underdeveloped in Ukraine.** The absence of a unified taxpayer account means that the tax administration cannot present taxpayers with access to a comprehensive and up-to-date record of the taxpayer's transactions and liabilities. Whereas taxpayer services delivered at the local level provide some information of the tax legislation, interpretations, and the taxpayer's own account status, these services are weak and fairly uneven due to the variance in administrative capacities. The tax administration does not provide free forms and guidance booklets. A taxpayer hotline telephone information service is in place, but somewhat weak in its effectiveness.

3.42 **Ukraine's tax payment system is streamlined, where the Treasury receives tax payments directly from the banking system,** with payment information flowing subsequently from Treasury to the STS. There are data exchange problems between Treasury and the STS that at present prevent taking full advantage of the data, such as matching revenues paid with assessed liability for receivables management.[15] The Bank is working with the Government to improve the data flows.

[15] The basis for eliminating discrepancies and improved reporting exists. Joint Treasury-STA Order 68/27/146, "On the Implementation of Daily Updating on Receipts into the State Budget of Urkaine," and Joint Order 74/194 of April 25, 2002, "On the Approval of the Policy for Interaction Between STA and Treasury Authorities as regards the revenue of State and Local Budgets," provide the basis for improved reporting and data reconciliation.

3.43 **Tax collections have improved, but not entirely due to improved administration and there is scope for systemic improvement**. Outstanding tax arrears have declined through end-2004 (latest year for which data is available) though only in part due to better collection administration. Total tax arrears declined from 15,421 million hryvnias at end-2002 to 14,993 million hryvnias end-2003 (2.8 percent decline) and further to 9,981 million hryvnias end 2004 (33 percent decline). The average collection ratio for the two years was 18 percent. Total tax arrears end-2004 of 9,981 million hryvnias represents 8.2 percent of 2004 consolidated government revenues. The 2006 Budget Guidelines (Cabinet and Parliament approved) prohibit netting tax arrears against payments owed by Government, giving a more accurate picture of arrears and collection efforts. It is not clear to what extent the decline in tax arrears was due to writing-off of the debt and other factors.

Expenditure Administration

3.44 **Absence of a coherent or clear cash management process, clear control arrangements, and clear assignment of execution responsibility has lowered predictability of spending commitments.** Cash management tasks are loosely divided between the MoF budget office, debt office and Treasury. Cash inflows are not forecast based on past patterns, but there is an annual apportionment of the revenue levels approved in the budget, broken down by month. Expenditures are not forecast, per se, but are fixed ex-ante in an annual apportionments (roszpys) from MoF (broken down by month). MDAs may enter into commitments for the fiscal year in accordance with their apportionment and allotments (Budget Code, Article 51(5)). MoF monitors monthly performance of actual revenue and expenditure against revenue and expenditure apportionments (required under the budget code, known as rozpys) but does not update apportionments unless an amendment is required. To the extent these apportionments serve as a baseline against which trends area measured, they might be considered a form of estimate. Estimation linked to cash planning and debt issuance does not exist. The debt office issues debt without reference to treasury balances (which can be as high as 20 percent of annual budget levels). Even so, the system does assure some degree of predictability in funds flow.

3.45 **MDAs know their annual budget and commitment level**. MDAs know their annual budget, and within one month of budget passage MoF provides Ministries (105 first-level budget users) with their annual apportionment, broken down by month and economic classification on a cash basis. Ministries break these plans into details for their departments (second-level budget users), who in turn break these plans down for agencies (third-level users). Most changes to the budget appear below the MoF, from Treasury and MDAs.

3.46 **Treasury cash controls are not integrated into a cash management system.** Treasury controls invoices to the MDA spending plans and apportionments, through 2006 also issued 10-day warrants authorizing spending units to bill up to the warranted amount in those ten days. While MDA's might enter into commitments up to their annual apportionment, per the budget law, the Treasury warrant system could limit payments orders to a lower amount—a system likely to generate payment delays and potentially

arrears. A recent French ADETEF (Assistance for the Development of Exchanges in Economic and Financial Technologies) report and also KRU report have noted significant problems in complying with terms of payment (e.g., due date). Changes in 2006, eliminating the warrant system, may help smooth the skewed cash outlay pattern where most payments occur in the last quarter of the fiscal year.

3.47 **Recording and reconciliation of cash balances, debt and guarantees is good.** Quality of debt data recording and reporting is good (for central government debt only, as subnationals and SOEs are not included). The State Debt Department reports on a monthly basis the status of the central government and government guaranteed debt. Changes in debt stock are reported every month, with general time series about nominal debt and debt-to-GDP ratio dating back from 1998.

3.48 **Treasury balances are known daily through TSA, except for donor-funded projects in special funds, some EBFs, national security and intelligence service nonpayroll funding.** A treasury single account (TSA) exists with the central bank, consolidating most liquid resources of the government. The account maintains real-time data about the available cash balances. There are though, extrabudgetary accounts that remain outside of the scope of the single treasury account, and according to information of the National Bank of Ukraine, which is the fiscal agent of the government, these include: pension and social insurance funds and diplomatic missions abroad. The single treasury account was established under Treasury Order Number 122 of June 26, 2002, pursuant to Presidential Decree Number 355/95, "On the State Treasury of Ukraine". No other publicly available information on the management of the liquid government resources.

3.49 **Special funds pose a challenge for cash management**. A December 16, 2005 ADETEF report noted that there were significant problems in TSA management with the existence of special funds. Treasury only provides banking services for special funds as part of the TSA. The earmarking of revenues to these special accounts does create problems in spending programs ability to enter into commitments and potential for arrears. Treasury controls do not apply to special funds. In 2004, special funds constituted 24 percent of total funds. While the general fund was executed at 99 percent of the original budget amount, special funds were executed at 92 percent of original budget.

3.50 **Procedures for contracting loans and guarantees are in place, but need to be strengthened and clarified**. MoF must approve all guarantees. Guarantees are rarely granted and often collateralized. Limits are required on the issuance of central government debt and guaranteed debt in the annual budget law (Article 18 of the Budget Code). The code also requires that the budget documents include a summary of central government debt and guaranteed debt showing the structure and obligations through to retirement, as well as a list of investments that are to be guaranteed. However, the terms of selecting and contracting projects backed by government guarantees are not stated in an officially published document and there is no website link referencing to information section on guarantees' contracting and procedures.

3.51 **Some payroll controls are in place, but there is scope for improvement**. No central reconciliation of payroll and personnel records is undertaken in the treasury system. Line ministries are presumed to do this. Design of new MoF/Treasury IFMIS is supposed to address this issue. Up to three months delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments. Ministries have clear rules, procedures and designated officials for changes to personnel and payroll records, with signatures and official stamps that produce an audit trail. (Note: quality of records management or retention not assessed.) There are two layers of audits on payroll. KRU, the central control and revision service, does annual payroll audits and are quite thorough. Ministries also have their own internal control and revision units per the budget code, but these are generally not deemed strong.

3.52 **Internal controls for nonsalary expenditures exist, but can be reinforced**. There are clear rules and procedures for expenditure commitment and approval in MDAs, and these are generally followed. The Treasury checks for appropriate approvals prior to executing payments. There is strictly limited use of irregular and simplified procedures. However, there appears to be some problems with the complementary period and recording transactions, which may indicate a need to reinforce compliance with treasury procedures. Moreover, the Accounting Chamber's 2004 Annual Report found 152 million hryvnia (0.2 percent of the 2004 budget total) intended for capital investment diverted to other uses; inappropriate accounting for fixed assets by budget users of 80 million hyrvnia (0.1 percent of the 2004 budget total); and construction costs above construction norms of 48 million hryvnia (0.06 percent 2004 budget total). While the amounts are small with respect to the entire budget, they do indicate some slippage in compliance. There is no evidence compliance is falling, but it is worth reinforcing internal controls.

3.53 **The commitment control system could better support MDA duties**. MDAs themselves are primarily responsible for managing commitments within ceilings, and maintain their own accounting systems for this purpose. A new treasury system should provide direct automated support to spending ministries to help them fulfill this task and link it closer to the treasury expenditure controls. In 2005 an automated commitment control system was piloted, and in 2006 it is being rolled out to all central government ministries. Once fully in place, an assessment of effectiveness can be made that may result in an "A". Heretofore, Treasury collected commitment information quarterly from agencies.

Procurement

3.54 **Procurement is an essential element of good budget execution** and can largely determine the extent to which funds are spent efficiently or resources wasted. Cornerstones of effective procurement systems are the use of competitive bidding, sound justification when noncompetitive methods are used, and the operation of a sound appeals mechanism.

3.55 **In Ukraine, through 2005 the procurement system appeared to be improving**. The percentage of competitive tendering procedures used was increasing annually from 83.5 percent of all procedures in 2003 to 88.3 percent in 2004 and to over 90 percent for

2005. The number of single-source contracts is fairly static at 16 percent by number of contracts and 24 percent by value of contracts over the previous two years. The major caveat to this data was it covered a very restricted subset of all government procurements.[16] Moreover, the ACU reported in 2004, "The most widely spread type of budget violation detected nearly in half of all control measures...was the use of the state budget funds breaching the Law of Ukraine: 'On the procurement of goods, works and services for state funds'." Totally, these violations amounted to 387.3 million UHA in 2004 (7.7 percent of the total amount of illegitimate use of the budget funds or 0.54 percent of the 2004 approved budget).

3.56 **The recent amendments to the public procurement law have created an entirely new system with confused roles and procedures**. There is insufficient data under the new system to evaluate whether competitive procurement methods are used. Moreover, even under the previous system, the number of exclusions suggests insufficient data to draw from conclusions. While Ukraine may have rated an 'A' in this element in 2004 and 2005, at present, it rates a 'D'.

3.57 **Some formal justification of the use of restrictive tendering was often made, but the substance of the justification was weak**. The finding of almost all controls (by the Accounts Chamber, KRU, and internal audits) point to unsubstantiated or weakly substantiated use of restrictive procedures as the main violations of the public procurement law (PPL). Moreover, the new PPL allows lower procedural thresholds for justification of restrictive tendering, reducing procurement system integrity.

3.58 **A procurement appeals mechanism existed**. In 2004 there were some 405 complaints lodged with the MoE of which only 59 were resolved; the remaining complaints were either rejected as entirely unsubstantiated or are still open. For the first six months of 2005 there were 281 complaints received and 72 resolved. Bidders did not appear to view this bid complaint resolution mechanism to be efficient, transparent, and trustworthy. Even so, in 2005 Ukraine may have scored 'B' rating.

3.59 **Recent procurement law amendments introduced an entirely new appeals mechanism**, whereby complaints need to be filed with either the procuring entity or the special Control Commission and with the Tender Chamber (NGO). The arrangement is not transparent and appears to open the system to administrative abuse by losing bidders. In the end, either price will be higher for the same or less quality and quantity of goods,

[16] Data do not include procurement of items listed in Art. 2, Clause 3 of the PPL: water, heat and power supply; waste water disposal and maintenance of sewerage systems; postal services, including postal stamps; the goods, works and services whose procurement is carried out by customers located outside of Ukraine, telecommunications services, including relay of radio and television signals (except for mobile telephony services and Internet services); railway transportation services; professional training, retraining and qualification improvement of workers in the state-owned technical vocational education establishments; training of staff by higher education establishments of accreditation levels I to IV and procurement of goods, works, or services that are a state secret due to their special purpose. SOE procurement is also excluded.

or quality and quantity of goods and services will fall under the new arrangements to the detriment of service delivery providers in health, education, and roads.

3.60 **Overall, procurement law amendments are not consistent with international standards, nor consistent with Ukraine's intention to harmonize with EU practices.**

Internal Audit

3.61 **Formal internal audit according to recognized international standards is still under development in Ukraine**. Internal control and revision operates at two levels: centrally via KRU (which has internal control and revision jurisdiction over all central government entities) and line ministry control and revision units. (As of January 2006, there were 49 units in MDAs of 2000 total units).

3.62 **Internal audit is partially effective**, with a reasonably strong central internal inspection service (that has good coverage but in need of modern audit approaches), good report distribution (KRU systematically distributes its reports to the MoF, audited entity, Accounting Chamber, posts its reports on its own webpage and publishes them in the Financial Control magazine), and some evidence of follow-up (60 percent of its audit findings are acted upon by management with 12 months). All internal control units have traditionally operated as inspection services using compliance audit techniques, and since 2002 have done a few performance audits for budget programs; and from 2006 have been piloting financial audits at budget entities and SOEs. Beginning in 2000, SIDA initiated a training program with KRU on administrative auditing and pilot programs were established. A formal unit was established in January 11, 2003 and is currently comprised of 16 HQ staff and 201 regional KRU officers solely engaged in performance auditing. KRU has established plans to undertake financial audits, and has requested training assistance.

3.63 **Government has directed KRU to modernize and harmonize with EU standards**. In 2005 KRU, in conjunction with the MoF, designed an Action Plan for the Implementation of the Concept of Development of Public Internal Financial Control (PIFC) for 2005-2009 which was approved by the Cabinet of Ministers. KRU is actively implementing the PIFC framework, and as further implementation occurs, the professional standards component and percentage of staff time dedicated to systems audit should improve. Five years is a realistic time-frame during which the major laws, rules, procedures, organizational arrangements, and training can be in place and operational. Further refinement in system operation would continue to occur after five years, but the essential architecture and operations would be in place. Ukraine has the advantage of a professional inspection service upon which to build the new architecture.

3.64 **Closer integration of KRU and MoF would enhance the effectiveness of both**. The April 2005 Presidential decree reorganizing MoF provided for closer work between KRU and MoF. MoF should have better access to KRU reports when making decisions and considering budget levels. KRU operates on the basis of an annual plan subject to endorsement by the Minister of Finance and approval by the CoM. MoF proposes targets

for revisions and audits to KRU's annual plan using MoF information on bottlenecks and problem areas.

E. ACCOUNTING AND REPORTING

	Accounting, Recording, and Reporting	
PI-22	Timeliness and regularity of accounts reconciliation	A
PI-23	Availability of information on resources received by service delivery units	B
PI-24	Quality and timeliness of in-year budget reports	C+
PI-25	Quality and timeliness of annual financial statements	D+

3.65 **PFM systems succeed or fail on the quality of accounting and reporting**. With absence of accurate data, properly accounted for and reported in useful formats in a timely fashion, Government, MoF, or MDAs cannot manage their funds, make appropriate decisions, improve efficiency, or be held accountable for actions taken.

3.66 **Ukraine assesses relatively well in most areas of accounting, recording, and reporting of expenditures**. Accounts reconciliation is continuous through the Treasury system and TSA at the National Bank (cash basis, covering most spending), and use of advances is regulated. Advances are permitted for recurrent spending where payments may occur prior to receipt of goods and services, but these are regularized within one month. Treasury states there are no simplified procedures for expediting payments. Advances are used for capital construction, but these are limited to 30 percent of annual allocation and no further funds are advanced unless a complete report on fund use is made.[17]

3.67 **The Treasury system provides generally reliable, complete information on most resources received by service delivery units**. Information is consolidated annually or more frequently as requested. Through the treasury system information on resources received by service delivery units is available online (within Government). But no specific report on this topic has been issued (it is generally not perceived as a problem). According to Accounting Chamber reports, some resources received directly by service delivery units are not captured during normal accounting. The KRU and Accounting Chamber both audit subnational governments at present.

3.68 **In-year budget reports are timely and of reasonable quality**. The Treasury system is used by most government entities, except non-payroll expenses of defense and internal security ministries and one EBF (pension). Coverage is generally good, and compatible with budget estimates.

3.69 **The most significant shortcoming of present reporting is the absence of a fully-implemented, automated commitment registration and reporting system**. Treasury has piloted a commitment system and is implementing it in 2006. The treasury system has some limitations on automated formatting and presentation that make the

[17] Regulated by Cabinet of Ministers Resolution Number 1764: On the Approval of Policy for Publicly Funded Captial Construction.

reports less than fully useful for the MoF. The accounting classification is compatible with budget classification, and comparison can be made at any level of detail (administrative, functional, economic, program).

3.70 **Expenditure reports are prepared at least monthly and quarterly** and transmitted to the MoF, which then posts on their website within 20 days of end of period. Daily balance reports are prepared and sent to the Minister of Finance.

3.71 **Reporting quality generally appears high, but the Accounting Chamber did note some problems with appropriate recording of spending**. Moreover, a December 16, 2005 ADETEF report did identify problems with the complementary period. While formally five days are allowed at the end of accounting periods to collect transactions for the previous period that might be in transit, in practice this period is one to two months. The size of adjustments post-period are not known, but this suggests problems in adherence to treasury procedures.

3.72 **Annual and quarterly financial statements are timely and of generally good quality**. A consistent set of national accounting standards is used, though these are not fully IPSAS-compliant and the standards are not publicly disclosed. Accounts are cash-based, though some elements of accrual accounting will be included (e.g., commitments).

3.73 **A consolidated government financial statement is prepared quarterly and annually** and includes all information on revenue, expenditure, and financial assets/liabilities, except for the pension fund. With pension fund spending at nearly 10 percent of GDP and a quarter of consolidated government spending, this is not an insignificant omission. The statement is submitted for external audit within five months of the end of the fiscal year.

F. External Scrutiny and Audit

	External Scrutiny and Audit	
PI-26	Scope, nature and follow-up of external audit	**D+**
PI-27	Legislative scrutiny of the annual budget law	**B+**
PI-28	Legislative scrutiny of external audit reports	**D+**

3.74 **Legislative scrutiny and external auditing are essential elements for assuring the integrity and learning feedback for both basic financial and performance information as well as policy.** They provide both the opportunity for learning as well as pressure for correcting problems in financial and performance information, and identifying externalities of policies that might otherwise go unnoticed. Their existence and transparent functioning provides a further assurance of integrity to public finance system operation that increases public and investor confidence in government.

3.75 **In Ukraine, external audit and legislative follow-up to audit are not adding as much value as they could, but the legislative is fully engaged in budget formulation and review.** The quality of external audit and legislative review of audits could be

strengthened to provide greater assurances of financial and performance information integrity. Legislative involvement in budget formulation and review is quite strong and the addition of medium-term forecasts and focus on strategic allocation issues would improve the assessment further.

3.76 **The Accounting Chamber of Ukraine (ACU), the supreme audit institution, is firmly established and well-funded**. Annual audits cover one-third of spending units, on a three-year audit cycle. The ACU now has clear authority over all public finances with the addition of revenue in January 2006. The ACU has the essential independence to carry out its role and is forceful in maintaining its independence.

3.77 **However, the nature of the audit is more compliance-oriented, with limited performance audits and no attestation of Government financial statements**. Audits predominantly comprise legality review, analytic work, and some transaction level testing, and reports identify some significant issues. The basis for ACU conclusions are not always clearly stated in annual reports. Further improvement is needed to reach INTOSAI standards for regularity and performance audits.

3.78 **Audit reports are submitted to the legislature within four months of the end of the fiscal year and findings are released to the media**. The ACU reviews and submits quarterly audit reports along with the Governments quarterly financial statements so they can quickly audit the fourth quarter and prepare an annual report (an analytic document rather than attestation). The ACU also makes direct use of the media, preparing press releases of report findings and releasing reports directly to the media. The ACU also has its own television program, "Accounts from the Accounting Chamber".

3.79 **There is limited evidence of legislative follow-up to ACU recommendations**. The 2004 ACU annual report includes an exhaustive list of follow-up actions by the Rada and Government agencies in response to Chamber findings and recommendations. The Chamber itself follows-up on previous recommendations during subsequent audits. However, for most recommendations, the ACU relies on ministries providing information on recommendation follow-up, and this does not always occur. In 2004, ten audited areas did not provide information on follow-up actions. The ACU itself has complained that while ministries may respond formally, the Cabinet does not. The Cabinet and MoF do not monitor the status of recommendations or assure a response has been made.

3.80 **The legislature's budget review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue**. The legislature debates budget guidelines for the upcoming year, usually in June, and approves the guidelines. These form the framework within which the budget is developed by the Government, and include aggregate fiscal and detailed policies, such as revenue earmarking (for special funds). As there is no medium-term framework produced, the legislature is not able to review it. The legislature reviews and provides input into the Government targeted programs and investment program. The Rada does have clear procedures for consideration of the budget, and a budget committee exists for detailed review of the budget. Sectoral committees may comment upon relevant sections of the budget as input to the budget committee.

3.81 **The legislature has at least two months to review the detailed budget proposals**. The Government submits the budget to the Rada by September 25, and the budget law targets Rada approval for December 1. In the summer (June), the Rada receives the aggregate spending limits and budget guidance for approval, enabling early focus on aggregate fiscal issues and some details of budget policy.

3.82 **Clear rules exist for in-year budget amendments by the executive and are respected**. While the rules are clear and adhered to, they do allow extensive administrative reallocation by MoF and by spending units. However, the MoF adjustments to apportionments are notified to Parliament (required by the Budget Code). While it is not apparent Parliament has the capability to review and act upon the information, it could do so. Rules for amending the budget are observed, most recently in the first quarter of 2005.

3.83 **Legislative consideration of audit reports is usually completed by the legislature within six months from receipt of the reports, but it is limited in depth and follow-up recommendations**. According to the 2004 ACU annual report, while the legislature takes action on its findings and government ministries also take action, the Government, as represented by the CoM, does not take action. However, there is no public accounts committee or other special committee assigned with detailed review of ACU reports. External reviews of legislative involvement found little legislative interest in ACU recommendations or recommendations for government action.

G. Donor Practices

	Donor Practices	
D-1	Predictability of Direct Budget Support	**NA**
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	**D**
D-3	Proportion of aid that is managed by use of national procedures	**D**

3.84 A large number of donors provide assistance to Ukraine (project funding, budget support, and technical assistance) totaling roughly two percent of GDP per year. The largest assistance providers are the EU, EBRD, World Bank, Japan (JBIC and grants), and the United States.

3.85 Ukraine is less dependent on foreign assistance financing than many countries, which lessens the impact of any volatile aid flows. However, there is insufficient information on aid flows in Ukraine to make any conclusions on volatility of aid and its impact on Ukrainian budget formulation or execution. Currently only the World Bank is providing budget support through its development policy lending (DPL) facility, but there is only one year of experience and no conclusions can be drawn at this stage.

3.86 Information on aid flows is sketchy and incomplete. Information flows from donors on planned and actual flows are weak. Donors provide little financial information to Ukraine for budgeting and reporting on project or program aid. Most donors do not provide budget estimates for disbursement of project aid as a matter of course, nor do

they provide quarterly reports to government on disbursements within two months of the quarters end.

3.87 Significant proportions of donor-financed activities operate outside the country's PFM system. Cash funding to government and public sector entities are typically included in the annual budget and reported in budget execution reports. Technical assistance and in-kind assistance are not reflected in the budget and budget execution reports.

3.88 Execution/management of donor-financed activities (other than budget support) typically follow special procedures that are different from the country's regular PFM system, e.g., banking arrangements, payments, procurement, accounting, financial reporting, and auditing. Technical assistance and in-kind assistance are typically managed or executed by the donor agency concerned and operate fully outside the country's PFM system, e.g., the donor agency manages the procurement, contract management, and payments (with some exceptions). Activities funded through cash assistance are typically executed or managed by the recipient entities, although even in these cases some functions are executed by the donor agencies, e.g., direct payments to contractors. Less than 50 percent of aid is managed using national procedures (procurement, payment/accounting, audit, and reporting). It is clear that progress on this issue depends both on the government's improvement of its PFM systems and on donors working together and assisting the government to move forward in using improved country systems. Recent changes to the procurement law in Ukraine (see indicator 19) will likely inhibit greater use of Ukrainian procurement procedures for the immediate future.

3.89 There are many donors currently engaged in supporting PFM reforms in Ukraine across a range of areas. Annex 3 is a current snapshot of donor activities in Ukraine's PFM system.

3.90 While there is no standing coordination of donor assistance in public financial management, there have been initial efforts to share ongoing and planned work by donors in the PFM area as well as occasional meetings among donors in-country. The Government has co-chaired some of these meetings, and more active coordination is useful. The MoF has an International Cooperation Office, which is also maintaining a list of donor activities, headed by Ms. Kolosova.

4. GOVERNMENT REFORM

4.1 Over the past five years, significant reforms were introduced into the Ukrainian PFM system to improve operations. These include:

- 2001 organic budget law to establish a modern budget system;
- 2001 adoption of formula for subnational transfers;
- 2002 introduction of a program budgeting classification for central government;
- 2003 introduction of program budgeting at selected local government;
- 2004 introduction of a passport system, whereby programs must have; performance targets and objectives for the coming fiscal year, signed by the relevant Minister and Minister of Finance, before proceeding to receive their annual budget allocation;
- 2004 full operation of an automated, financial management information system and treasury, focused on core functions of treasury (accounts payable, receivable, general ledger), and treasury single account;
- 2005 Presidential decree bringing Treasury, KRU, tax and customs under the oversight of MoF. In December 2005, Treasury was formally integrated into the MoF with the objective of creating a strong Ministry of Finance with adequate authority to manage the county's public finances. This was accompanied by an internal reorganization of MoF functions to improve operations;
- 2005 Government adoption of a KRU reform program focused on adoption of modern internal audit and control systems in Ukraine over several years with a goal of bringing Ukraine into alignment with EU Public Internal Financial Control principles;
- 2005 MoF decision to proceed with an upgrade of the Treasury IFMIS system to a more integrated system and incorporating the management information needs of key actors in Ukraine's PFM system, including MoF;
- 2006 Rada-initiated procurement law reforms that have radically modified the roles and responsibilities for procurement system management and oversight; and
- 2006 passage of amendments to the auditing law giving KRU responsibility for auditing state-owned enterprises (as well as the Accounting Chamber), as a short-term measure, to assure adequate information on SOE performance. The existing SOE Internal Control framework includes a requirement for internal controls and audit, and annual external audits, but this system has not been operating adequately to assure sound financial management.

4.2 Some recent measures continue to be implemented or refined. For example, the program budget classification has not been fully used in analyzing program needs during the budget preparation process. The KRU modernization program is underway, but will require continuous work and attention over several years to fully realize. The integration of MoF components into a more integrated unit is still underway as is strengthening MoF capacity to undertake policy analysis for revenue and expenditures.

Institutional Factors Influencing Reform

4.3 PFM reform in Ukraine has a long history from independence in 1991, tied closely to the transition to a market economy which is some respects is still underway. Reforms in the early and mid 1990's were aimed at stabilizing public finances and beginning to structure PFM in a more orderly fashion, culminating in the first budget code of 1996. Subsequent refinements sought to put in place a more modern PFM architecture, including a treasury, leading to the current budget code of 2001.

4.4 Government interest in reform has waxed and waned throughout the period. While various parts of the MoF have had interest in selective PFM reforms, these have not always been accompanied by high-level political interest in reform. By the early 2000's some bilateral donors began ending their technical assistance in support of PFM reform for lack of progress, even as some reforms continued such as establishment of the treasury system. Reform progress was highly dependent on having a few senior officials in MoF committed to reform and at least political acquiescence to changes. Changes tended to be more narrow, focused on one area such as program budgeting.

4.5 Late 2004 saw renewed impetus for PFM reform at higher levels and across the PFM system. The challenge of amending the 2005 budget in early 2005 further galvanized the need for improvements across the MoF, and led the Minister of Finance Pynzenyk specifically to urge changes to organizational structures and operational capacity.

4.6 MoF has had a Modernization Office since 2002 attached to the Office of the Minister. As a permanent structure with no broader consensus for reform within MoF, it had limited effectiveness or connection to MoF operations.

4.7 In 2005, the MoF reorganization eliminated this office, and the task of coordinating reform has fallen to a Working Group for preparation of a Public Finance Modernization Project. The chair and deputy chair of the Working Group are Deputy Ministers of Finance, and the group includes representatives at Department Director level or above (e.g., Treasurer). Technical subgroups were also formed informally, such as the IT Directors of the main units (MoF, KRU, Treasury).

4.8 The MoF is working to have a Cabinet of Ministers resolution approved that would establish a formal Interministerial Working Group on PFM reform. The Interministerial WG would allow formal inclusion of key players outside MoF in planning and managing the reform, such as the MoE and some key users (Cabinet of Ministers Secretariat and first-line budget users).

4.9 The current MoF Working Group has enabled pooling of middle management experience and operational knowledge to develop the reform strategy and link it to action plans and donor support.

4.10 Important factors in the progress achieved to date include the high-level interest from Ukraine's President and Council of Ministers in improved government management, the strong commitment of the Minister of Finance in improving MoF

operations, strong leadership from the Deputy Minister's leading the work, and broad MoF middle management involvement in directing the work (keeping it operationally relevant).

4.11 For procurement, a separate locus of reform has developed in the Parliament itself, which led the early 2006 procurement law revisions. The new structure is predominantly outside executive branch management, and involves the ACU and nongovernmental organizations in managing the process. As noted elsewhere, this new structure is not consistent with EU practices or international standards, and it is unclear how Government might assure procurement practices within the executive branch are modernized.

4.12 A Parliamentary election in March 2006 has produced a new Government in August 2006. It is not clear whether the new Government would continue to support broad PFM modernization, but the expectation is for continued PFM reforms.

ANNEX

ANNEX 1: UKRAINE SEPTEMBER 2006

PFM Performance Measurement Assessment

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	A. PFM OUT-TURNS: Credibility of the budget		
PI-1	Aggregate expenditure out-turn compared to original approved budget	**B**	Aggregate expenditure varied by -11% in 2002, 0.4% in 2003, +10% in 2004 and -6% in 2005.
PI-2	Composition of expenditure out-turn compared to original approved budget	**B**	Composition variance exceeded Aggregate Variance by 6% in 2002, 5.3% in 2003, 2% in 2004 and 0.7% in 2005. Composition variance exceeded aggregate variance by more than 5% in only one of the past three years, and therefore an 'B' is warranted.
PI-3	Aggregate revenue out-turn compared to original approved budget	**A**	Aggregate central government revenue was 94 % of planned collections in 2002, 99 % in 2003, 100 % in 2004 and 97 % in 2005. But this masks some variation in the composition of revenues, suggesting forecasting challenges yet to be overcome.
PI-4	*Stock and monitoring of expenditure payment arrears*	**B+**	
	(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.	A	The IMF October 2005 Statistical Appendix reports the stock of budget payment arrears at the end of 2004 at 720 million hryvnias, or 0.5 percent of 2004 consolidated government expenditures. The stock of arrears has generally declined from end-2002 when they stood at 2,253 million hryvnias or 2.7 percent of consolidated government expenditures. In 2004, there were certain wage arrears and arrears generated by local authorities. It is not clear that reforms have been implemented to prevent these sources of arrears from re-emerging. Treasury reports it undertakes manual updates with spending units on a monthly basis. The design of the current budget execution systems permits arrears to be generated. See budget execution discussion under PI-16(ii) for more details. A December 16, 2005 ADETEF report noted that there is potential for large unrecorded and unbudgeted arrears and tax refunds. IMF 2004 Transparency ROSC notes, "Accounts payable and bills due for payment are recorded as part of the commitments management facility of the treasury system. These data have been used in the past as a basis for payments arrears reporting."

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			The Accounting Chamber's 2004 Annual Report identified local government arrears to the central government and absence of mutual settlement totaling 976 million hryvnia (1.4 % of the 2004 budget total). However, automated commitments modules were only piloted in Treasury in 2005, for rollout in 2006.
	(ii) Availability of data for monitoring the stock of expenditure payment arrears	B	Information on arrears exists at line ministries, which maintain an accrual accounting system. Spending units register payables with the STU IFMIS, but only those payables the spending unit intends to meet. Spending units also provide monthly reports to Treasury, and Treasury reconciles their cash accounting with MDA accrual accounting systems monthly. Spending units also provide consolidated payables and receivables reports to the MoF on a quarterly basis. Treasury reports significant discrepancies between the consolidated reporting and monthly reporting. In late 2006, a system was adopted whereby the full monthly allotment for protected expenditures is released by Treasury. For non-protected items (roughly 20% of spending), Treasury proposes weekly releases for MoF approval. Treasury has introduced an automated commitment control system in 2006 that will allow improved monitoring of arrears. A December 16, 2005 ADETEF report noted that there is potential for large unrecorded and unbudgeted arrears and tax refunds.
	B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		
PI-5	Classification of the budget	**A**	Administrative, economic and program classification exist for the national government, following GFS standards.
PI-6	Comprehensiveness of information included in budget documentation	**A**	Budget includes all 9 sets of information. Debt stock, including details at least for the beginning of the current year, is included in the budget. The reporting on debt stock is sufficiently detailed and reported on the website 25 days after the month-end. However, there is no systematic registration of state enterprise debt and no central registry of subnational debt. The SOE sector is large, and ministries may use SOE creation as a form of off-budget spending–a double concern as SOEs can contract debt which is not monitored. Financial Assets, including details at least for the beginning of the current year, are

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			included in the budget. Although the statistics on the consolidated budget performance are up-to-date and complete, there is not enough information on the activities and the financial results with respect to the cash management of the MoF. Information about the investments or financial assets of the government is not publicly available at the website of the MoF or the National Bank. The treatment of capital spending could be improved in reports. The classification does provide sufficient detail to allow understanding of capital spending trends, but these are not always broken down in spending reports. For example, the budget includes total capital spending, and indicates total spending has increased since 2001. However, most of this increase was in capital transfers (subsidies) to enterprises, rather than fixed capital investment. Regular use of detailed classification in reporting would more transparently indicate these important policy issues.
PI-7	Extent of unreported government operations	**D+**	
	(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e., not included in fiscal reports.	D	Many former EBF's have been converted to on-budget special funds (earmarked revenues). EBF financial flows are included in the annual budget, and EBFs other than the pension fund are included in the treasury system. Extrabudgetary funds include the pension fund, the social insurance fund, the fund for protection of the disabled, and the unemployment fund. In 2004, expenditures from these four funds accounted for 11% of GDP and 29% of total consolidated budgetary expenditure , with the pension fund alone accounting for 9.6% of GDP and 24.7% of total consolidated budgetary expenditure. However, the EBFs do provide periodic fiscal reports. A March 2006 SIGMA PEM assessment found that, "the annual state budget covers revenue and expenditure transactions of all central government entities except: (i) four extra-budgetary funds (EBF); and (ii) local state administration bodies, which are covered by local budgets together with local self-government bodies." Also according to the March 2006 SIGMA PEM assessment, "The most significant off-budget expenditures are the quasi-fiscal activities undertaken by public enterprises. These quasi-fiscal activities are diminishing but remain significant, notably in the energy sector, where they would account for about 6% of GDP." Six percent of GDP for 2005 translates into approximately 22% of expenditure.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			Given the size of SOE quasi-fiscal activity, which is not reported, the scoring for this is a 'D'. Absent QFA, Ukraine would score an 'A', as no significant extrabudgetary fund expenditure goes unreported (though report quality and timelines of EBFs could be improved).
	(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.	A	PIU's are required to report expenditures monthly from special accounts of donor-funded projects to the bookkeeping unit of the implementing ministry, which in turn reports to MoF. Information is consolidated into monthly financial execution reports. Missing elements are grants, which have no regulation covering reporting, and in-kind assistance.
PI-8	Transparency of inter-governmental fiscal relations	**B+**	
	(i) Transparent and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations)	B	A formula-based budget calculation for local government budgets has been used since 2001. The formula is included in the budget law, which also specifies intergovernmental fiscal relations. There are three components to local government resource transfers: revenue sharing; expenditure equalization formulas, and other parallel capital transfers. The revenue sharing component is transparent and operates well. However, since its adoption in 2001 the expenditure equalization formula has become less transparent. Adjustment coefficients in the formula are modified by MoF staff on an ad hoc basis, and subnational governments do not understand these changes. The parallel capital transfers, where subnational governments apply for resources, operate without clear rules. World Bank staff estimate that 20-50 % of annual funds to subnational governments are not transparently allocated. The IMF 2004 Transparency ROSC notes, "The budget code defines the responsibilities of different levels of government and establishes a stable basis for intergovernmental fiscal relations," (para 12, p. 11).
	(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year	B	SN governments receive estimated allocation information within 45 days of central government agencies. Actual allocations are only known after the Rada passes the budget, which the budget law indicates should be by December 1 (the fiscal year begins January 1). However, subnational governments, like other budget users, receive information on proposed allocations earlier, before completion of their own budget deliberations.
	(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories	A	SN governments use the Treasury system for bookkeeping and transactions, allowing continuous consolidation for reporting.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			As plans for greater decentralization of spending authority to local governments and regions progresses, local treasury offices may be transferred to subnational or local government control. This may have an adverse affect on subnational reporting and consolidation.
PI-9	Oversight of aggregate fiscal risk from other public sector entities	**D+**	
	(i) Extent of central government monitoring of AGAs and PEs	D	SOE oversight is weak and fragmented. State Property Fund has formal managerial responsibility on behalf of government, along with line ministry responsible for SOE. The Ministry of Economy (MoE) has responsibility for evaluating the financial performance of SOE;s, but this is not done consistently or thoroughly. SOEs are required to have internal audit units, and annual external audits. However, the system is viewed as weak. In January 2006, Parliament passed amendments to the accounting law giving KRU central audit authority over SOEs, and KRU is implementing an aggressive audit effort with SOEs. The Accounting Chamber (SAI) was also given authority over SOEs, but has not previously audited nor is it currently auditing SOEs. MoF should be actively monitoring expenditures, but little actual monitoring occurs at present. A 2005 KRU report found some SOE managers engaging in export fraud to maximize VAT receipts. Parliament is concerned and taking some measures. In addition to changes to the audit law enabling KRU oversight, Article 115 of the 2006 Budget Law states, "Within two months the Cabinet of Ministers of Ukraine shall develop and approve the procedure limiting administrative expenses of business entities in the public sector of economy with respect to the used of official cars, consulting, insurance and audit services; regulating other operating expenses not related to core business; determining that the procedure and method of doubtful debt provision creation and write-off of doubtful debts of public sector entities shall be specified by a resolution of the authorised management body."
	(ii) Extent of central government monitoring of SN governments' fiscal position.	A	Subnational governments operate through the Treasury and cannot expend more than their budget. Treasury can monitor these, and sends regular reports to MoF. Subnational governments of certain size may incur debt, but MoF must approve. MoF has special department for subnational budget preparation and monitoring, though actual active monitoring is reportedly not taking place. Annual financial reports are consolidated national and subnational government reports.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
PI-10	Public access to key fiscal information	**B**	(i) A complete set of documents can be obtained by the public through the MoF and Rada website when it is submitted to the legislature. (ii) Monthly and quarterly financial reports are prepared within days of period end by Treasury, and submitted to MoF. Section 28 of budget code gives MoF alone the right to disclose budget execution. MoF consolidates with external funding, and publishes monthly within 20 days of period end. Government officials also have on-line access to Treasury database. (iii) Year-end financial statements are available to the public within days of year-end prior to audit. (iv) Extrernal audit reports. Annual summary reports of audit findings are posted on the Chamber web site, audit findings are presented to the Rada and public. [18] (v) Contract awards. The procurement law requires all contract awards to be published within one week. It is not clear if this is followed in practice. Informational provision in the public procurement sphere is effected by publishing announcements on the planned bids and on their results in the Public Procurement Herald information and analytical bulletin, as well as at the Cabinet of Ministers web page (www.kmu.gov.ua). In addition, at the MoE web page, other informational materials are placed such as: normative acts on public procurement, analytical features, international bid announcements (www.me.gov.ua). A web version of the Public Procurement Herald has been created (www.tender.com.ua). Two regional editions of Public Procurement Herald information and analytical bulletin have been established: Public Procurement Herald – Eastern Region and Public Procurement Herald – Southern Region. The new procurement law has not been in force long enough to know if information will be less transparent than previous PPL. (vi) Resources available to primary service units are known. Treasury has this information for first, second, and third-line budget users and it is used for expenditure control. But it is not actively monitored by MoF or publicly released. It has not been viewed as a problem. In sum, only elements (i) through (iv) are available. Four elements translates into a 'B' assessment.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	C. BUDGET CYCLE		
PI-11	Orderliness and participation in the annual budget process	**B+**	
	(i) Existence of and adherence to a fixed budget calendar	B	Call circular generally issued in early June, with submissions due end-June. The calendar is generally followed. Ministries have four weeks to submit their budget form the time of the call circular issuance. If extended two more weeks, an 'A' score would be achieved.
	(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent)	B	Expenditure limits set by MoF in April/May, transmitted with call circular. Cabinet approves economic estimates used as the basis for budget preparation. Cabinet also approves aggregate spending levels prior to their transmission to Rada. Cabinet does not approve sector ceilings at circular stage. The Cabinet and Rada do approve annual budget guidelines prior to issuance (Guidelines for 2006 Budget were approved by the Rada in June 2005), which provides the broad policy directions to be followed in budget development. In sum, there is policy official involvement early in the budget process, but it does not include cabinet approval of sector ceilings. It would be relatively simple to further develop the Guidelines into a fiscal policy paper that provides more context and identifies risks, and also include indicative sector ceilings.
	(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years)	A	Yes. The Rada approved the budget for 2006 on December 20, 2006. For the last three years the budget has been approved before the start of the fiscal year. A March 2006 SIGMA PEM assessment noted that, "Since 1998, the state budget law has been passed before the start of the fiscal year, except in 2001."
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C**	
	(i) Preparation of multi -year fiscal forecasts and functional allocations	C	Economic estimates are multi-year (3-year), but budget estimates and aggregate budget ceilings are only one year. Capital estimates are multi-year. 2004 IMF Transparency ROSC reports, "The budget document discloses the main fiscal aggregates for two years prior to the budget year and three years beyond the budget year. The Explanatory Notes volume, gives a summary overview of the main state and local budget aggregates (excluding EBFs). The summary table shows revenue, expenditures, balance, and financing for actual spending two years prior to the budget, revised outturn for the current year, and forecasts for the budget and three succeeding years," (para 26, p. 18).

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	(ii) Scope and frequency of debt sustainability analysis	A	DSA is done once a year by NBU. The MoF only maintains a spreadsheet with a pipeline of debt payments, and does not itself perform a debt sustainability analysis embedded in a Macrofiscal framework and considering contingent liabilities.
	(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure;	D	No formal requirement exists for multi-year sector strategies. Transportation, with large capital expenditures, does have a multi-year strategy, but this covers capital but not recurrent spending.
	(iv) Linkages between investment budgets and forward expenditure estimates.	D	There are no multi-year ceilings, sector strategies, or multi-year recurrent estimates, so the linkages are weak. Government (Cabinet of Ministers) does designate targeted programs annually, reflecting an implicit government-wide strategy of sorts, and these are not costed multi-year or well-integrated into decision-making.
	C(ii) Predictability and Control in Budget Execution		
PI-13	Transparency of taxpayer obligations and liabilities	C	
	(i) Clarity and comprehensiveness of tax liabilities	C	The lack of a unified Tax Code and a Single Administrative Act on tax procedures result in a complex and ambiguous legislative base for tax liabilities and taxpayer compliance. A number of substantial tax exemptions were repealed in early 2005. This simplified the tax base and rates somewhat. However, the legacy of a decentralized administrative structure, weak information systems, and limited skills – combined with the complexity of and ambiguities in the tax legislation – result in substantial variations in the actual determination and enforcement of tax liabilities. Other legislative features hamper the tax administration's ability to monitor and enforce compliance. It is hard for the tax administration to deny registration or de-register taxpayers (including VAT) on the basis of non-compliance history. The administration does not have the power to correct obvious arithmetic errors in declarations, without initiating an audit. Nor has it the power to issue a default assessment in the event of a stop-filer. It has no access to banking information in the course of a civil audit. It cannot seize bank accounts of tax debtors. Audit powers are generally restricted to financial accounting information, as contrasted with assessments of the underlying economic activity. Interest on tax debts does not accrue during an appeal – providing strong incentives to appeal. Appeals must be settled within 30 day – a short period for handling the complexities of large taxpayers – and an incentive for the taxpayers to stall in providing information. Tax disputes are adjudicated in favor of the taxpayer in the event of contradictions or ambiguities in the legislation. The administration cannot skip either notification steps, in the event of an enforcement action when there is a history of

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			taxpayer non compliance. The administration has little powers to disregard transactions that have no economic basis and are aimed at tax avoidance. Weaknesses in the legislation and in the tax administration's (decentralized) systems also hinder the administration's ability to implement unified taxpayer accounts. This limits the ability of the tax administration to provide an authoritative and comprehensive record of transactions and obligations to the taxpayer. Similar weakness prevent the tax administration from being able to effectively and in a timely manner consolidate tax liabilities and transactions for analysis, internal audit, and for sharing with the other fiscal entities – i.e., the MOF, and the customs administration. The weaknesses in tax account aggregation and inter-agency information sharing prevents the MOF from having a good understanding of the level and structure of accrued tax liabilities, as distinct from the cash tax payments data which comes from the Treasury. The ongoing World Bank State Tax Service Modernization Program is addressing many of these weaknesses, especially in the administrative capacity. It is, however, an extended multi-year process. Moreover, the legislative reforms are highly dependent on the configuration and intention of the incoming parliament and the yet-to-be formed new government.
	(ii) Taxpayer access to information on tax liabilities and administrative procedures.	C	The absence of a unified taxpayer account means that the tax administration cannot present taxpayers with access to a comprehensive and up-to-date record of the taxpayer's transactions and liabilities. Whereas taxpayer services delivered at the local level provide some information of the tax legislation, interpretations, and the taxpayer's own account status, these services are weak and fairly uneven due to the variance in administrative capacities. The tax administration does not provide free forms and guidance booklets. A taxpayer hotline telephone information service is in place, but somewhat weak in its effectiveness. The ongoing World Bank State Tax Service Modernization Program includes substantial strengthening of taxpayer services, including the implementation of unified taxpayer accounts, a multimodal national contact center, as well as the provision of forms and other printed taxpayer materials.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			A 2004 IMF Ukraine: Report on the Observance of Standards and Codes—Fiscal Transparency Module noted significant and frequent changes in tax code, exemptions, and guidance on tax liability. Significant administrative discretion also adds to the confusion. Tax payers are not sure of their liabilities.
	(iii) Existence and functioning of a tax appeals mechanism	C	A three tier administrative tax appeals system has been established. Improvements in the tax legislation and in the tax administration's skills and resources are needed to improve its effectiveness and transparency. The ongoing World Bank State Tax Service Modernization Program includes the modernization and strengthening in the appeal procedures and systems.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C	
	(i) Controls in the taxpayer registration system	C	Ukraine has implemented a unified business register, including for taxes. The tax administration has weak powers to deny tax registration on the basis of poor compliance histories. This includes for VAT, which creates serious problems for the integrity of the VAT payment chain. The ongoing World Bank State Tax Service Modernization Program includes substantial improvements in the procedures and system for registration. The Treasury system receives tax payments directly from the banking system, but there are data exchange problems with the STS that at present prevent taking full advantage of the data. A World Bank Public Finance Modernization program under development includes improving data exchanges between MoF/Treasury and STS and Customs Administrations.
	(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	C	Penalties for non-compliance generally exist, but changes to their structure and application are needed to give them a real impact on compliance. As noted above, a number of legislative features encourage appeals, delays and court proceedings. The ongoing World Bank State Tax Service Modernization Program includes improvements in the procedures and systems associated with tax accounting, including the application of penalties, fines and voluntary work-out arrangements.
	(iii) Planning and monitoring of tax audit and fraud investigation programs	C	Ukraine has a national audit program. However, the transition from a comprehensive, document-based audit approach to a selective, risk-based audit of the underlying economic activity of taxpayers is quite a way from completion. Legislation, technologies,

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			skills and institutional culture are all constraining factors. Fraud investigations are handled by the tax militia in relatively militarized, enforcement-oriented fashion. Risk-based methods also need to be developed and applied in criminal investigation. The ongoing World Bank State Tax Service Modernization Program includes substantial improvements in the procedures and systems of audit and investigation, including risk-based selection and performance evaluation.
PI-15	Effectiveness in collection of tax payments	**D+**	
	(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years)	D	According to the November 2005 IMF Statistical Appendix for Ukraine (Table 27), tax arrears declined from 15,421 million hryvnias at end 2002 to 14,993 million hryvnias end 2003 (2.8% decline) and further to 9,981 million hryvnias end 2004 (33% decline). The average collection ratio was 18 percent. Total tax arrears end 2004 of 9,981 million hryvnias represents 8.2 percent of 2004 consolidated government revenues. Historically, the pattern of arrears has depended substantially on forgiveness and the accounting of arrears by state owned enterprises. In Ukraine, 2003 and 2004 were relatively good "statistical" years for reasons that really don't reflect positive developments in administration. The 2006 Budget Guidelines (Cabinet and Parliament approved) prohibit netting tax arrears against payments owned by Government. This will give a more accurate picture of arrears. The positive change in compliance during 2005 probably reflects the change in the political economy in Ukraine following the 2004 Presidential Elections. These effects probably exceed any changes due to administrative capacity. They may or may not be permanent depending on the trajectory of the political economy. The ongoing World Bank State Tax Service Modernization Program includes improvements in the procedures and systems associated with enforced collection.
	(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration	A	In Ukraine, revenues come from the banking system directly to the Treasury, with payment information flowing from Treasury to the STS.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	D	As noted above, weaknesses in the tax administration's system prevent effective consolidation and aggregation of tax accounting information and the timely exchange with the MOF/Treasury. The ongoing State Tax Service Modernization Program includes the implementation of unified taxpayer accounts, central consolidation and inter-agency information exchange.
PI-16	Predictability in the availability of funds for commitment of expenditures	**D+**	
	(i) Extent to which cash flows are forecast and monitored	D	Cash in-flows are not forecast, per se, but there is an annual apportionment of the revenue levels approved in the budget, broken down by month. .Expenditures are not forecast, per se, but are fixed ex ante in an annual apportionments from MoF (broken down by month). The debt office undertakes debt issuance without reference to TSA account balances. MoF does monitor monthly performance of actual revenue and expenditure against revenue and expenditure apportionments (required under the budget code, known as rozpys) but does not update apportionments or make revised estimates to year-end. While monthly monitoring is in place, estimation is not undertaken, and cash planning linked to debt issuance does not exist. The debt office issues debt without reference to treasury balances (which can be as high as 20% of annual budget levels).
	(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment	A	MDA's know their annual budget, and within one month of budget passage MoF provides Ministries (105 first-level budget users) with their annual apportionment, broken down by month and economic classification on a cash basis. Ministries break these plans into details for their departments (second-level budget users), who in turn break these plans down for agencies (third-level users). Treasury controls spending to these plans and apportionments. Full monthly cash releases are made for protected spending items, and weekly cash releases are proposed to MoF for approval for the unprotected spending items (20 percent of spending). (A March 2006 SIGMA PEM assessment noted that, "...warrants detail payment authorisation on a daily basis. Generally, payments are prioritised according to their economic nature, priority being given to wages and salaries, social contributions, and debt-servicing payments.") There is no central, automated commitment control system in place, though the Budget Code does limit total commitments to the annual budget or apportionment. MDAs do maintain commitment accounting in order to fulfill their obligations, and this is

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			reconciled quarterly with Treasury accounts (cash basis). The current apportionment system is not working well, where MoF allocates 1/12 of annual budgets to spending units, and does not take into account seasonal fluctuations in need. Treasury warrants complicate the picture. A significant problem in cash management exists from the special funds, which include ear-marked revenues. If forecasts are off, or revenues do not materialize, spending commitments will be lower than budgeted, creating potential for arrears. Unlike the General Fund, where spending authority terminates at the end of the fiscal year, special fund balances may be carried forward indefinitely. Execution rules are also less stringent for special funds.
	(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs	D	The MoF apportionment controls of first-level users is transparent (Parliament receives these), and changes are also sent to Parliament. These change once or twice per year. At this level, Ukraine would score an 'A' rating. Until Septemeber 2006, a Treasury warrant system, meant to control short-term cash outflow, operated and was not transparent, and may result in lower expenditures than committed funds. These were issued every 10 days. This warrant process scored a 'D.' As of Spetember 2006, a new system was put in place where protected spending items (80% of spending) receive their full monthly allotment. For the unprotected items, Treasury proposes weekly cash releases that MoF approves. This is a substantial improvement, and system performance should be re-evaluated in 2007 to assess whether changes to allocations have improved and a higher score is warranted. A December 16, 2005 ADETEF report noted that there are frequent modifications to allotments, including reductions in allotments, intra-budgetary transfers, and these are not transparent or well managed. However, most of these changes occur below the MDA level, initiated by MDAs themselves.
PI-17	Recording and management of cash balances, debt and guarantees	**B**	
	(i) Quality of debt data recording and reporting	A	Quality of debt data recording and reporting is good. The caveat here is that the score applies to central government debt only, subnationals and SOEs are not included. Ukraine is a regular member of the SDDS system of the IMF and as such should comply with the criteria for comprehensive and regular reflection of key fiscal data and macroeconomic statistics.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			The State Debt Department is an integral part of the Ukrainian Ministry of Finance and pursuant to a Presidential decree is a primary source of information on government and guaranteed by the government debt. Commencing in 2004, the unit reports on a monthly basis the status of the central government and government guaranteed debt. The information comes in three languages – Ukrainian, Russian and English, with the data in the Ukrainian version being the most thorough, both in terms of contents and frequency of the updates. The depth and the quality of the published debt information are satisfactory, compared to the similar dissemination practices of other CEE countries. Changes in debt stock are reported every month, with general time series about nominal debt and debt-to-GDP ratio dating back from 1998. The breakdown by components includes: ➢ data on foreign and domestic debt; ➢ creditors; ➢ currency composition; ➢ interest rate composition; and ➢ tradable debt, broken down by tenors. The figures are reported both in local currency and in US dollars. The same reporting approach is applied for the government guaranteed debt. Debt service schedules by month are provided for 2004 only. The information for 2005 has not been updated yet. Another shortcoming is the absence of methodological notes about the compilation of debt, supporting the figures. In SDDS templates, it is indicated that brief methodological information can be obtained from Ukraine Statistical Yearbooks and the website of the Statistics Institute. Even though the government has started publishing information on the tax revenue performance of the municipal authorities, there is still no information on their liabilities, i.e., direct debt, trade credits and other arrears, which may pose considerable credit risks for the government, given the speeding up of reforms and investment activity in the country
	(ii) Extent of consolidation of the government's cash balances	B	Treasury balances known daily through TSA, except for donor-funded projects in special funds, and some EBF's. In August 2006, a law transferred national security and intelligence service non-payroll funding to Treasury. A single Treasury account exists with the central bank, consolidating the liquid resources of the government. The account maintains real-time data about the available cash

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			balances. There are though, extrabudgetary accounts that remain outside of the scope of the Single Treasury Account, and according to information of the National Bank of Ukraine, which is the fiscal agent of the government, these include: pension and social insurance funds and diplomatic missions abroad. The set up of a Single Treasury Account is arranged in the National Bank Law (Article 31) and there is no other publicly available information on the management of the liquid government resources. A December 16, 2005 ADETEF report noted that significant problems in TSA management with the existence of special funds. While Treasury reports that special funds are part of the TSA, the earmarking of revenues to these special accounts does create problems in spending programs ability to enter into commitments and potential for arrears, which suggests they are not entirely integrated into the TSA. In 2004, special funds constituted 24% of total funds. While the general funds was executed at 99% of the original budget amount, special funds were executed at 92% of original budget.
	(iii) Systems for contracting loans and issuance of guarantees	C	MoF must approve all guarantees. Guarantees are rarely granted, and often collateralized. Limits are required on the issuance of central government debt and guaranteed debt in the annual budget law (Article 18 of the Budget Code). The code also requires that the budget documents include a summary of central government debt and guaranteed debt showing the structure and obligations through to retirement, as well as a list of investments that are to be guaranteed. However, the terms of selecting and contracting projects, backed by government guarantees are not stated in an officially published document and there is no website link referencing to information section on guarantees' contracting and procedures.
PI-18	Effectiveness of payroll controls	**D+**	
	(i) Degree of integration and reconciliation between personnel records and payroll data	D	No automated, central reconciliation of payroll and personnel records undertaken in current treasury system. Line ministries are presumed to do this. Design of new MoF/Treasury IFMIS is supposed to address this issue. KRU audits do reconcile, but these are at best annual exercises.
	(ii) Timeliness of changes to personnel records and the payroll	C	Manual personnel records systems results in delays in record processing and payroll adjustment. Average time to process is not known, and the extent of retroactive payroll adjustments is not known, but these are estimated to be no more than 3 months.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	(iii) Internal controls of changes to personnel records and the payroll	A	Ministries have clear rules, procedures and designated officials for changes to personnel and payroll records, with signatures and official stamps that produce an audit trail. (Note: quality of records management or retention not assessed.) A 2005 World Bank HR survey of 391 personnel managers found 58 percent felt their reports of personnel and personnel costs met reasonable quality standards and were useful to program managers.
	(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers	A	There are two layers of audits on payroll. KRU, the central internal inspection service, does annual payroll inspections, and are quite thorough. Ministries also have their own internal inspection units per the budget code, but these are generally not deemed strong.
PI-19	Competition, value for money and controls in procurement	**D+**	
	(i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)	D	For 2004, 112,822 procedures were held for competitive procurement procedures, which include open bids, two-tier bids, restricted participation bids, price quotation bids; this amounts to 88.3% of the overall number of procedures (in 2003, the share of competitive procedures came to 83.5 per cent). The number of procurements from a single participant has come to 14,977 which has amounted to 11.7 per cent from the total number of procedures. The figures available for 2005 indicate a continuation of this trend for increase in competitive tendering, available figures indicating that over 90% of all tenders use competitive methods. The number of single source contracts is fairly static at 16% by number of contracts and 24% by value of contracts over the previous 2 years. This year's (2004) figures by comparison are 12% by volume and 26% by value. Note also that these data do not include procurement of items listed in Art. 2 Clause 3 of the PPL where the latter excludes the following objects from its application: water, heat and power supply; waste water disposal and maintenance of sewerage systems; postal services, including postal stamps; the goods, works and services whose procurement is carried out by customers located outside of Ukraine, telecommunications services, including relay of radio and television signals (except for mobile telephony services and Internet services); railway transportation services; professional training, re-training and qualification improvement of workers in the state-owned technical vocational education establishments; training of staff by higher education establishments of accreditation levels I to IV and procurement of goods, works or services that are a state secret due to their special purpose. SOE procurement is also excluded. While formally meeting the criteria for an "A", for 2004 and 2005, the Accounting Chamber (Ukraine's Supreme Audit Institution) reported in its 2004 annual report that,

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			"The most widely spread type of budget violation detected nearly in half of all control measures...was the use of the state budget funds breaching the Law of Ukraine, 'On the procurement of goods, works and services for state funds'." Totally, these violations amounted to 387.3 mln. UHA in 2004 (7.7% of the total amount of illegitimate use of the budget funds)." [0.54% of the 2004 approved budget] The Accounting Chamber also noted that, "Analysis of compliance with the Law of Ukraine, 'On the procurement of goods, works and services for state funds', while using the funds of the state budget of Ukraine in 2002-2003 conducted by the Accounting Chamber in the reporting year showed that the most typical violations of legislation on the procurement were the violations connected directly with the competitiveness and transparency of state procurement." The recent amendments to the public procurement law have created an entirely new system with confused roles and procedures. There is insufficient data under the new system to evaluate whether competitive procurement methods are used. Moreover, even under the previous system, the number of exclusions suggests insufficient data to draw form conclusions. While Ukraine may have rated an 'A' in this element in 2004 and 2005, at present, it rates a 'D'. The new institutional framework resulting from the 2005 amendments to the PPL created three key players, in public procurement supervision and control, in addition to Parliament. These are: the Antimonopoly Committee [AMC] (as Authorized Agency), the Accounting Chamber - through the special Control Commission, and the Tender Chamber (an NGO). This situation leads to a large number of anomalies, duplication of responsibilities, lack of clarity and hence confusion in the execution of control and supervision of public procurement. The involvement of the Antimonopoly Committee in supervision, monitoring and coordination of public procurement goes well beyond the usual role and competence of such an entity, which is normally responsible for oversight of competition policy in the enterprise sector. The establishment of a special Control Commission at the Accounting Chamber is inconsistent with international practice in which a supreme audit institution provides independent oversight on the state budget, and is not involved in its execution. Finally, granting a private, non-governmental organization (the Tender Chamber of Ukraine) the authority to make binding decisions in the area of public procurement without any administrative responsibility creates a quite unique and confusing situation.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			In essence the new legislative framework for public procurement is at variance with international practice and with Ukraine's stated objectives of harmonization with European norms. The law also appears to create a fundamental conflict by granting to parliament responsibilities that are normally those of the executive branch The recent CPAR update conducted by the Bank (May, 2006) reviewed the performance indicators against which the efficiency of a public procurement system can been measured. These indicators cover important areas of the procurement cycle such as: use of procurement methods, direct contracting, bid protest resolution, late payments, price increases, and selection methods for consultants. A comparison between the satisfactory benchmark thresholds and the actual levels of achievements in Ukraine shows that the country needs to improve its procedures and practices to enhance the efficiency of the use of public funds.
	(ii) Extent of justification for use of less competitive procurement methods	C	In order to use the less competitive methods (restricted tendering and sole source) all public spending units need to seek specific clearance and this may only be given with provisions clearly laid down in the PPL. The clearance should be provided by the Authorised Agency (currently the AMC). However, this in fact is a two step procedure as the AMC can only provide such permission on receiving the positive opinion of the special Control Commission of the Accounts Chamber, the alternative for the spending unit is to receive a positive opinion from the Tender Chamber. The above arrangement for control of the use of less restrictive methods corresponds to international practices and is generally satisfactory. However, the two alternative approaches that can be followed may lead to some confusion and it is expected that most spending units wanting to use less competitive procedure will apply to the Tender Chamber as this requires only a single step and furthermore the Treasury has issued an internal instruction indicating that the opinion of the Tender Chamber is sufficient. It is hoped that this apparent relaxation will not lead to an increase in the use of sole source procurement. The other concern with this arrangement is that the opinions and decisions of the Tender Chamber (unlike the Accounts Chamber and AMC) can exclusively be questioned through a judicial rather than administrative procedure. So while less competitive methods are formally justified in accordance with regulatory requirements (a 'B'), these regulatory requirements are confused and have recently been weakened. The finding of almost all controls (by the Accounts Chamber, KRU and internal audits) point to unsubstantiated or weakly substantiated use of restrictive procedures as the main violations of the public procurement Law.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	(iii) Existence and operation of a procurement complaints mechanism	C	An appeals mechanism exists - In 2004 there were some 405 complaints lodged with the MoE of which only 59 were resolved, the remaining complaints were either rejected as entirely unsubstantiated or are still open. For the first six months of 2005 there were 281 complaints received and 72 resolved. Bidders did not view this bid complaint resolution mechanism to be efficient, transparent, and trustworthy. In 2005, Ukraine would have likely scored 'B' rating. The amendment of 2005 introduced an entirely new mechanism, whereby complaints need to be filed with either the procuring entity or the special Control Commission and with the Tender Chamber. The complaint is then reviewed by the Tender Chamber and an opinion must be made and passed to the Control Commission who makes the final decision. However given that the opinions of the Tender Chamber can only be challenged by a judicial procedure, it would appear that the role of the Commission is merely an administrative one and the actual resolution is made by the Tender Chamber (an NGO), this clearly is not either an ideal or transparent situation. Furthermore the current legislation required that any procedure is suspended for 20 days once a complaint is filed. There is evidence that Bidders make use and take advantage of this provision (by filing tenuous complaints) in order to gain additional time for the preparation of their bids. In conclusion, in respect of these two sub-indicators although clear mechanisms exist (spelt out in the PPL) their implementation (for both sub-indicators) have some serious shortcomings which require the nature of the whole public procurement system to be addressed. Furthermore, it is not without consequence that the finding of almost all controls (by the Accounts Chamber, KRU and internal audits) point to unsubstantiated or weakly substantiated use of restrictive procedures as the main violations of the public procurement Law.
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	
	(i) Effectiveness of expenditure commitment controls	B	In 2005, an automated commitment control system was piloted, and in 2006 it is being rolled-out to all central government ministries. Once fully in place, an assessment of effectiveness can be made that may result in an "A". Heretofore, Treasury collected commitment information quarterly from agencies. Agencies themselves are primarily responsible for managing commitments within ceilings, and maintain their own accounting systems for this purpose. A new treasury system should provide direct automated support to spending ministries to help them fulfill this task and link it closer to the treasury expenditure controls.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			Treasury indicated in late 2006 that it receives daily information on commitments for main spending units on an economic, program, and geographic classification. This was not consistent with information received from Treasury previously, and should be reassessed in a follow-up assessment.
	(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures	B	Internal controls (other than debt, payroll, and advances addressed elsewhere) for goods and services, some wages, staff allowances within Treasury clear and generally followed. Within MDA's rules are clear, but compliance can be reinforced. The Accounting Chamber's 2004 Annual Report found: ➢ 152 million hryvnia (0.2 % of the 2004 budget total) intended for capital investment diverted to other uses; ➢ Inappropriate accounting for fixed assets by budget users of 80 million hyrvnia % of the 2004 budget total); and ➢ Construction costs above construction norms of 48 million hryvnia (0.06 % 2004 budget total). While the amounts are small with respect to the entire budget, they do indicate some slippage in compliance.
	(iii) Degree of compliance with rules for processing and recording transactions	C	There is strictly limited use of irregular and simplified procedures. However, there appears to be some problems with the complementary period, and recording transactions, which may indicate a need to reinforce compliance with treasury procedures.
PI-21	Effectiveness of internal audit	C+	
	(i) Coverage and quality of the internal audit function	C	Formal internal audit according to recognized international standards is still under development in Ukraine. Internal audit and inspection operates at two levels: centrally via KRU, which has internal audit and inspection jurisdiction over all central government entities; and line ministry internal audit units. (As of January 2006, there were 49 IA units in MDA's of 2000 total units.) All internal inspection units have traditionally operated using compliance audit techniques, and have not done financial or performance audits and since 2002 have done a few performance audits for budget programs, and from 2006 have been piloting financial audits at budget entities and SOE. Beginning in 2000, SIDA initiated a training program with KRU on administrative auditing, and pilot programs were established. A formal unit was established in January 11, 2003, and is currently comprised of 16 HQ staff and 201 regional KRU officers solely engaged in performance auditing. In 2005, KRU in conjunction with the MoF designed an Action Plan for the Implementation of the

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			Concept of Development of Public Internal Financial Control (PIFC) for 2005-2009 which was approved by the Cabinet of Ministers. KRU is actively implementing the PIFC framework, and as further implementation occurs, the professional standards component and percentage of staff time dedicated to systems audit should improve.
	(ii) Frequency and distribution of reports	A	KRU systematically distributes its reports to the MoF, audited entity, and Accounting Chamber (SAI), and posts its reports on its website and publishes them in Financial Control magazine.
	(iii) Extent of management response to internal audit findings.	B	According to KRU data, 60 % of its audit findings are acted upon by management within 12 months.
	C(iii) Accounting, Recording and Reporting		
PI-22	Timeliness and regularity of accounts reconciliation	**A**	
	(i) Regularity of bank reconciliations	A	Treasury accounts (cash basis) are continuously (daily) reconciled with the Treasury Single Account through the treasury system. Treasury cash-based accounts are reconciled quarterly with MDA accrual-based accounts.
	(ii) Regularity of reconciliation and clearance of suspense accounts and advances	A	According to Treasury, for recurrent spending, no advances are permitted, and there are no simplified procedures for expediting payments. Advances are used for capital construction, but these are limited to 40 % of annual allocation and no further funds are advanced unless a complete report on fund use is made. However, a March 2006 SIGMA PEM assessment noted that, "Payment can be made before goods are delivered or services rendered, but in such cases the transactions must be regularised within one month., This advance payment procedure for operating expenditures should be abolished, except for some special cases (such as travel expenses)."
PI-23	Availability of information on resources received by service delivery units	**B**	The Treasury system provides generally reliable information on most resources received by service delivery units. Information is consolidated annually, or more frequently as requested. According to Accounting Chamber reports, some resources received directly by service delivery units are not captured during normal accounting. The KRU and Accounting Chamber both audit subnational governments at present.
PI-24	Quality and timeliness of in-year budget reports	**C+**	
	(i) Scope of reports in terms of coverage and compatibility with budget estimates	C	The Treasury system is used by most government entities, except non-payroll expenses of defense and internal security ministries and one EBF (pension). Coverage is generally good, and compatible with budget estimates.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			The classification is compatible with budget classification, and comparison can be made at any level of detail (administrative, functional, economic, program). However, the current Treasury system captures transactions, and not all commitments. A commitment module is being implemented in 2006. This is corroborated by the IMF 2004 Fiscal Transparency ROSC which notes that,"The variance between budgeted and actual outturn of the main fiscal aggregates is disclosed and explained to the Rada. The report on budget execution presented to the Rada includes a comparison of budget outcomes with the original budget estimates for revenue and expenditure programs. During the year, monthly budget execution reports show actual revenue and expenditure as a proportion of the budget estimate for the year. Within year revenue and expenditure plans are not published with the result that there is no solid basis to assess budget execution before the end of the fiscal year," (para 52, p. 30).
	(ii) Timeliness of the issue of reports	A	Reports are prepared monthly and quarterly, and transmitted to MoF. MoF posts on their website, within 20 days of end of period. Daily balance reports are prepared and sent to the Minister of Finance. IMF 2004 Transparency ROSC notes, "Summary monthly reports provided by the STU are posted on the MOF website (http://www.minfin.gov.ua/minfin/index.jsp) around 20 days after month-end," (para 40, p. 27).
	(iii) Quality of information	B	Quality generally appears high, but the Accounting Chamber did note some problems with appropriate recording of spending. Moreover, December 16, 2005 ADETEF report did identify problems with the complementary period. While formally 5 days are allowed at the end of accounting periods to collect transactions for the previous period that might be in-transit, in practice this period is 1-2 months. The size of adjustments post-period are not known, but this suggests problems in adherence to treasury procedures. The ADETEF report also noted problems in adhering to terms of payment for contracts, suggesting further problems in adherence to Treasury procedures (the Treasury 10-day warrant system likely contributes directly to this problem, imposing invoice triage when adjusted below apportionment levels).
PI-25	Quality and timeliness of annual financial statements	**D+**	
	(i) Completeness of the financial statements	D	A consolidated government statement is prepared quarterly and annually and includes full information on revenue, expenditure and financial assets/liabilities, except for the pension

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			fund. With pension fund spending at nearly 10 % of GDP and a quarter of consolidated government spending, this is not an insignificant omission.
	(ii) Timeliness of submission of the financial statements	A	The statement is submitted for external audit within five months of the end of the fiscal year. (May)
	(iii) Accounting standards used	C	National accounting standards are applied, and while known within Government are not included in budget or reporting documents. According to the IMF 2004 Fiscal Transparency ROSC, "Statements of accounting policy are not included in the budget and final accounts documents, but are clearly stated for administrative purposes. Neither the budget documents nor the State Budget Execution Statement contain statements of accounting basis or accounting policies. However, policies are clearly explained within the administration. Treasury accounting is largely on a cash basis, but some elements of accrual data (such as balance sheet presentation, debt data, and limited data on financial assets) are also included in statements. A presidential decree, as recently modified, requires that the treasury move to an accrual basis of accounting by 2007, but, at present, accounting standards are not fully compliant with International Public Sector Accounting Standards (IPSAS)."
	C(iv) External Scrutiny and Audit		
PI-26	Scope, nature and follow-up of external audit	**D+**	
	(i) Scope/nature of audit performed (incl. adherence to auditing standards)	D	IMF 2004 Transparency ROSC notes that, "The Accounting Chamber performs regular audits of the expenditures of key spending units of the central government. The audits cover 30-35% of the spending units every year—all are covered over an audit cycle of three years," (para 56, p. 31). "The scope of audit conducted by the Accounting Chamber is limited to observations of compliance…" (para 50, p. 29). And also that "Audit is largely limited to the examination of propriety and regularity of Expenditure," (para 55, p.31). And "A more extensive audit, and in depth review of government finances, would be needed to attain satisfactory international standards of external oversight," (para 57, p. 32). Audit reports do identify significant issues. Audit standards are disclosed to a limited extent only.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			ACU authority was expanded in January 2006 to include revenues. Previously, the ACU could only review expenditures. ACU authority now includes central budgetary funds, earmarked funds, extra-budgetary funds and budgetary subsidies. It does not include, however, funds from external assistance. ACU remit includes the National Bank of Ukraine, the State Property Fund, and the Antimonopoly Committee, local state administration, local self-government bodies, enterprises, institutions, organisations, banks and non-governmental entities as well as other bodies and institutions spending budgetary funds, and private persons to the extent of the state funds they receive or manage. The ACU authorizing statute will need to be amended to reflect the expanded scope over revenues. A March 2006 OECD SIGMA external audit assessment noted that audit reports are primarily analytic in nature, with limited transaction testing, regularity (financial) assessment, and no performance assessment (according to international standards). The ACU does not have an audit manual, though a unit within ACU exists to promulgate standards and has issued numerous guidelines to auditors. The SIGMA report concludes: "The existing methodological framework of the ACU audit work is insufficient, as it mostly focuses on procedural aspects. Therefore further work is needed to adapt the recognized international standards and to implement them into the work practice."
	(ii) Timeliness of submission of audit reports to legislature	A	Audit reports are submitted to the legislature within 4 months of the end of the fiscal year. The Accounting Chamber reviews and submits quarterly audit reports along with the Governments quarterly financial statements, so they can quickly analyze the fourth quarter and prepare an annual report. The ACU annual report is not an attestation of Government financial statements, but only an analytic document. ACU does not perform regularity audits. The ACU has internal targets for every unit to provide one audit report per quarter Other audit reports are submitted in a timely fashion. The ACU also makes direct use of the media, preparing press releases of report findings and releasing reports directly to the media. The ACU also has its own television program "Accounts from the Accounting Chamber." (SIGMA Report) The ACU is also obligated to submit suspected legal infractions to law enforcement bodies, and there were 15 such cases in 2005. (SIGMA Report)
	(iii) Evidence of follow up on audit recommendations	B	There is some evidence of follow up. The 2004 ACU annual report includes an exhaustive list of follow-up actions by the Rada and Government agencies in response to

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
			Chamber findings and recommendations. The Chamber itself follows-up on previous recommendations during subsequent audits. However, for most recommendations, the ACU relies on ministries providing information on recommendation follow-up, and this does not always occur. In 2004, ten audited areas did not provide information on follow-up actions. (SIGMA report) The ACU itself has complained that while ministries may respond formally, the Cabinet does not. The Cabinet and MoFinance do not monitor the status of recommendations or assure a response has been made. The MoF does not include in annual budget development whether there are outstanding ACU recommendations, or if a response has been made or disagreement with findings registered with ACU.
PI-27	Legislative scrutiny of the annual budget law	**B+**	
	(i) Scope of the legislature's scrutiny	B	The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. The summer aggregate spending guidelines provide the Rada with an early opportunity to review and debate larger issues of fiscal policy. As there is no medium term framework produced, the legislature is not able to review it. The legislature does review and provide input into the Government Targeted Programs and investment program.
	(ii) Extent to which the legislature's procedures are well-established and respected.	A	The Rada does have clear procedures for consideration of the budget, and a Budget Committee exists for detailed review of the budget. Sectoral committees may comment upon relevant sections of the budget as input to the budget committee. New spending proposals are reviewed by the Budget Committee before proceeding to the floor for a vote, and changes are discussed with the Government. Article 40(2) of the Budget Code sets clear guidance on the nature of legislative amendments to the budget. "Proposals to increase State budget expenditures shall identify the sources to fund additional expenditures; proposals to reduce State Budget revenues must identify the sources to cover the losses of revenues of the State budget of Ukraine or the expenditures that are to be cut. No one such proposal may lead to increases in the State debt and or guarantees in comparison to the amounts included in the proposed draft State Budget Law of Ukraine. If at least one of these requirements is not met, the relevant proposal shall not be accepted for consideration by the Verkhovna Rada Budget Committee. Proposals to amend the forecast of tax receipts are not permitted. It is not allowed to make proposals regarding changes in the forecasted tax receipts…"

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
	(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)	A	The legislature has at least two months to review the budget proposals. The Government submits the budget to the Rada by September 25, and the budget law targets Rada approval for December 1. In the summer (June), the Rada receives the aggregate spending limits and budget guidance for approval, enabling early focus on aggregate fiscal issues and some details of budget policy.
	(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature	A	The 2001 Budget Code allows the MoF to lower MDA spending limits if monthly budget execution reports show revenues are less than expenditures. (Article 54(1)). If quarterly budget execution reports show revenues are 15% below expected levels for the quarter, the Cabinet of Ministers must submit budget amendments to Parliament within two weeks of the quarterly report, and the Parliament has two weeks to act on the amendments. (Article 54(2)). If actual revenues are 15% or more above budgeted levels for the first three-quarters of the year, the Cabinet must submit proposed amendments to the Parliament by October 30 of the fiscal year. Article 55 of the 2001 Budget Code provides for the annual budget law to protect some areas from having their allocations reduced in year. The annual budget laws do in fact include such designations, and these are respected (see analysis for indicators PI-1, PI-2 above and in report). Article 49 of the 2001 Budget Code requires the MoF to approve an apportionment of spending for all budget users within one month of budget enactment. The apportionment must comply with the budget law, and be provided to Parliament. The basis (e.g., monthly, annual) is not specified, but is currently a monthly basis. MoF is also required to notify Parliament of any modifications to the apportionment (e.g., reductions). Treasury is reqired to execute the budget according to the apportionment. While the rules are clear, and adhered to, they do allow extensive administrative reallocation by MoF and by spending units. However, the MoF adjustments are notified to Parliament. While it is not apparent Parliament has the capability to review and act upon the information, it could do so. The issue of extensive administration discretion is not quite material given the clarity of rules on amendment, and therefore an 'A' rating is warranted.

	Indicator	Score	Explanation of Scores of Each Indicator Dimension, and Evidence
PI-28	Legislative scrutiny of external audit reports	D+	
	(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years)	B	Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports. MF 2004 Transparency ROSC notes, "The legislature discusses external audit reports, but systematic review is limited," (para 57, p. 32). The March 2006 SIGMA external audit assessment concluded, "In parliament there is no special committee responsible for considering all of the ACU's work, but reports and information submitted by the ACU, including the annual report on ACU activities, are discussed either by the whole parliament or by its relevant committees."
	(ii) Extent of hearings on key findings undertaken by the legislature	D	No in-depth hearings are conducted. There is no specific committee in Parliament such as a Public Accounts Committee. The March 2006 SIGMA external audit assessment noted, "According to the ACU Act, parliament may authorise a relevant committee to carry out analyses of the impact of ACU work and compliance with instructions (in principle at least twice a year), but these analyses have never been made. Conclusions of such analyses could potentially strengthen pressure on auditees for the implementation of ACU recommendations. Little importance seems to be attached to ACU reports by the State Budget Committee, which does not regard them as adding any value in comparison to government reports. There is also limited interest in ACU proposals for legislative changes." IMF 2004 Transparency ROSC notes, "...the Budget Committee of the Rada does not examine the final accounts in depth," (para 50, p. 29).
	(iii) Issuance of recommended actions by the legislature and implementation by the executive	D	The legislature discusses ACU reports, but does not take action or make recommendations itself. Actions are recommended to the executive by the ACU, some of which are implemented, according to existing evidence. According to the 2004 annual report of the Accounting Chamber, while the legislature takes action on its findings and government ministries also take action, the Government, as represented by the Cabinet of Ministers, does not take action.

	Indicator	Score	Explanation of scores of each indicator dimension, and evidence
	D. DONOR PRACTICES		
D-1	Predictability of Direct Budget Support	**NA**	
	(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).	NA	Ukraine is less dependent on foreign assistance financing including budget support than many countries, which lessens the impact of any volatile aid flows. Currently only the World Bank is providing budget support (Development Policy Loans –DPLs). This indicator is therefore less relevant in the Ukraine context and is not assessed.
	(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	NA	As currently structured World Bank DPLs are single-tranche operations and so disburse shortly after World Bank Board approval. No quarterly plan is applicable.
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	**D**	
	(i) Completeness and timeliness of budget estimates by donors for project support.	D	Most major donors do not provide budget estimates for disbursement of project aid.
	(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.	D	Most donors do not provide quarterly reports within 2 months of end-of-quarter on the disbursements made.
D-3	Proportion of aid that is managed by use of national procedures	**D**	Less than 50 % of aid funds are managed using national procedures. Recent changes to the procurement law and system will likely inhibit increased use of national procedures, at least for procurement.

ANNEX 2: MULTILATERAL AND BILATERAL ASSISTANCE TO UKRAINE IN PFM 2005-2006+

Ukraine Public Financial Management
Multilateral and Bilateral Assistance
March 2006

Item	Organization	Area	Activity	Amount	Time Frame
1	**CIDA**	National, Regional Economic Forecasting	The Socio-economic Performance and Potential Analysis Capacity project is a three year project implemented by the Conference Board of Canada in partnership with the International Centre for Policy Studies. The project will promote a closer alignment of regional and central policies by developing new capacities to measure and forecast both regional and national economic potential and socio-economic performance using internationally accepted methods. The project will use an internationally accepted framework of 40 - 50 socio-economic indicators, which will assess both current performance as well as potential performance. The potentials dimension will identify realistic goals that can drive policy decisions. The project will be carried out in partnership with the Ministries of Economy and Finance, the National Bank of Ukraine and the State Commission on Statistics.	Total Budget: C$2,771,634 CIDA Contribution: C$2,323,470	2006+
2	**DFID**	Regional strategic planning, including PFM	Lviv, Donetsk and Lugansk. Developing the capacity of local administrations for strategic budgeting as a tool for implementing local strategies for social and economic development • Comprehensive training for local officials at oblast and sub-oblast levels in PFM and strategic budgeting • Organisational change in local administration to introduce horizontal coordination in budget development • Support to inter-departmental working groups designing regional investment projects	Lviv: £1.4 million Donbas: £6.8 million	Sept 2003 - Aug 2007 to April 2007

Item	Organization	Area	Activity	Amount	Time Frame
3	**DFID**	Social Service Sector Public Financial Management	Enhancing the capacity of Ukrainian government at national and regional level to formulate, implement and evaluate policies and financial delivery mechanisms for social services. • Benchmarking, reviewing and developing strategies for finance and policy making and their interlocutors • Review of national and local level financing mechanisms with initial recommendations prepared • Developing frameworks for the Accounting Chamber in the context of social services reform. • Comprehensive package of technical notes in preparation (areas addressed include economic evaluation and assessment of unit costs, taxation of potential alternative service providers, demographical trends, EU best practices in social service planning and licensing). • Engaging the key ministries into the reform dialogue and enhancing their skills for implanting the recommendations	£3 million	Nov 2004 - June 2008

4	**EU**	Public Finance	EU-Ukraine Action Plan (21-9-04) priorities for action include
			• tax reform,
			  o improved Tax Administration and
			  o sound management of Public Finances (p. 3).
			• Action areas considered important include:
			  o 'ensure the effectiveness of the fight against corruption' (via promotion of transparency and accountability of administration) (p. 3);
			  o 'introduce strategic planning at the national and regional levels' for regional development (p. 8);
			• customs legislative and administrative reform, including training and computerisation of customs (pp. 9-10);
			• tax system development, including solving VAT refund backlog and preventing re-accumulation of arrears, comprehensive strategic plan for STA that addresses administrative structures and procedures,
				NA	NA

Item	Organization	Area	Activity	Amount	Time Frame
			financial, human, and IT resources (pp. 13-14); • public procurement reform, improvements to transparency, information and training (p. 15); • public financial control, including treasury accounting (strategy for modernizing, integration of EBF's), internal financial control (restructuring concept, legislation, harmonization of standards and methods), and external audit and control (capacity building, EU cooperation) (pp. 15-16).		
5	**EU**	Internal Audit	• New Twinning Agreement for KRU • Four components: 1. Assistance in establishing a sound legal framework; 2. Assistance to the Central Harmonisation Unit in developing its structure and its relationship with line ministries 3. Assisting the CHU in developing methodologies and techniques for internal control and internal audit. 4. Training	Euro 1.2 million	Sept 2007-Sept 2009
6	**EU**	Procurement / Competition	Project in the Competition area which will include Public procurement component. It is expected that the project will deal, in particular, with the following aspects: • Optimization of legislative base by achieving approximation with EU rules (with reference to the recent EU directives in the field) in order to ensure due consideration of the key principles of transparency, non-discrimination, competition and access to legal recourse. • Maintain control system over observation of competition principles in the field of public procurement, development of effective practices for dispute settlement and appeal on tenders. • Develop information technologies in support of public procurement • Enhance exchange of experience, information about best practice and regulatory frameworks between relevant Ukrainian and EU authorities.	?	Early 2008

Item	Organization	Area	Activity	Amount	Time Frame
			• Develop the legal culture of entities of public procurement market participants through delivery of targeted training programmes and advice during public procurement processes. The detailed ToRs will be drafted in summer. Activities could start early next year. The precise budget will also be determined later, as currently the component is included in the large-scale project with the common budget for several components.		
7	**EU**	Debt Management, Budget Forecasting	Twinning project for the MoF, for which the aim will be to support the MoF of Ukraine in the process of improving Public Debt Management and Budgetary Forecasting (the project is at the very early stage of elaboration, more details could be provided later).	?	?
8	**France**	Treasury reform, administration, decentralization reform, IT systems and automation	French Ministry of Finance ADETEF (Assistance for the Development of Exchanges in Economic and Financial Technologies) bilateral assistance, supporting study tours and training in France, and short-term advisory missions to Kiev. Managed from Paris. Contact: Daniele Lajoumard, Inspecter General of Finance, French Ministry of Economy, Finance and Industry E-mail: daniele.lajoumard@igf.finances.gouv.fr	??	??
9	**France**	Internal Audit	New, 2-year agreement between French Inspection Service and KRU to share experience. Part of French Ministry of Finance ADETEF (Assistance for the Development of Exchanges in Economic and Financial Technologies) bilateral assistance, supporting study tours and training in France, and short-term advisory missions to Kiev. Managed from Paris. Contact: Daniele Lajoumard, Inspecter General of Finance, French Ministry of Economy, Finance and Industry E-mail: daniele.lajoumard@igf.finances.gouv.fr	??	2005-7
10	**France**	Public Procurement	French Ministry of Finance ADETEF bilateral assistance, supporting Anti Monopoly Committee.		

Item	Organization	Area	Activity	Amount	Time Frame
			Contact: Daniele Lajoumard, Inspecter General of Finance, French Ministry of Economy, Finance and Industry E-mail: daniele.lajoumard@igf.finances.gouv.fr		
11	**France**	Customs reform, administration, valuation techniques; anti-money laundering	French Ministry of Finance ADETEF (Assistance for the Development of Exchanges in Economic and Financial Technologies) bilateral assistance, supporting study tours and training in France, and short-term advisory missions to Kiev. Managed from Paris. Contact: Daniele Lajoumard, Inspecter General of Finance, French Ministry of Economy, Finance and Industry E-mail: daniele.lajoumard@igf.finances.gouv.fr		
12	**France**	Tax reform, administration, VAT management, technical systems, transparency, local versus central control of local tax authority	French Ministry of Finance ADETEF (Assistance for the Development of Exchanges in Economic and Financial Technologies) bilateral assistance, supporting study tours and training in France, and short-term advisory missions to Kiev. Managed from Paris. Contact: Daniele Lajoumard, Inspecter General of Finance, French Ministry of Economy, Finance and Industry E-mail: daniele.lajoumard@igf.finances.gouv.fr		
13	**France**	Ministry of Finance and Ministry of Economy coordination and reform	New agreement signed with Ministries of Finance and Economy. Part of French Ministry of Finance ADETEF (Assistance for the Development of Exchanges in Economic and Financial Technologies) bilateral assistance, supporting study tours and training in France, and short-term advisory missions to Kiev. Managed from Paris. Contact: Daniele Lajoumard, Inspecter General of Finance, French Ministry of Economy, Finance and Industry E-mail: daniele.lajoumard@igf.finances.gouv.fr		
14	**GTZ**	MoF organization, performance management, reform management	German GTZ received request for assistance from First Deputy Minister Maksyuta 2005. Likely GTZ will provide some support in at least one area, not yet decided. Contact: Matthias Witt, Sr Economist in Public Finance, GTZ. E-mail: matthias.witt@gtz.de Dmitry Sennychenko, Program Coordinator, GTZ Kiev E-mail: Dmitry.Sennychenko@gtz.org.ua		2007

Item	Organization	Area	Activity	Amount	Time Frame
15	**IMF**	Macrofiscal and financial management	IMF macroforecasting advisor, Michele Marion, assigned to MoF Macroeconomic Department.		2006-2007
16	**US Treasury**	Macroeconomic Policy	Macroeconomic management. Resident advisor (Economist assigned to PM office). Contact: Sheila Tschinkel, macroeconomics cabmin@gmail.com		2006-7
17	**US Treasury**	Budget, Macrofiscal	Financing • Performance Program Budget system for the MoF, including IT for budget preparation and macrofiscal analysis and modeling • Support for adoption of IFRS • training for MoF budget office staff in budget preparation and macroeconomic analysis • Support a public awareness, public participation in the budget process	$4 million	2005-7
18	**USAID**	Subnational Budget	Supporting a 3-year project to install 'performance program budgeting' in 130-140 cities in Ukraine, including software, hardware, and training.	$10 million	2005-8
19	**World Bank**	Tax Administration	Supporting Tax Modernization Project in STA	$40 million	2004-2008
20	**World Bank**	Intergovernmental Finance	Supporting via Development Policy Loan (DPL), Public Expenditure Review II (on-going)		2007
21	**World Bank**	MoF, State Treasury, IFMIS, debt mgmt, internal audit, budget formulation, budget execution, capital budgeting, macroeconomic forecasting, personnel mgmt and payroll calcs.	Supporting implementation of an integrated Public Financial Management System. Phase I (interim treasury) completed in 2004, phase II under preparation via PHRD grant. Project may be around $65 million. PHRD may be supplemented with Project Preparation Facility. Includes advisory support on PFM reform, workshops.	$0.674 million	2006+

Item	Organization	Area	Activity	Amount	Time Frame
22	**World Bank**	Debt Management	Assessment and advice on debt management and debt market development. Peripatetic.	NA	2005-7
23	**World Bank**	Internal Audit	Through the World Bank Institute, support with a short-term consultant to assist KRU in developing Cabinet of Ministers Resolution establishing international standards in internal control and audit.	@US$ 10,000	April-May 2007
24	**World Bank / Dutch**	Capital Budgeting, MTEF	Under development. A possible Dutch Grant to support DPL II with a combination of analytic work, methodology development and training to address problems identified in the 2006 Public Finance Review and PEFA report, including capital budgeting, MTEF, policy costing and prioritization, special funds, PPPs, strategic planning.	@US$ 700,000	??

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ANNEX 3: REFERENCES

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