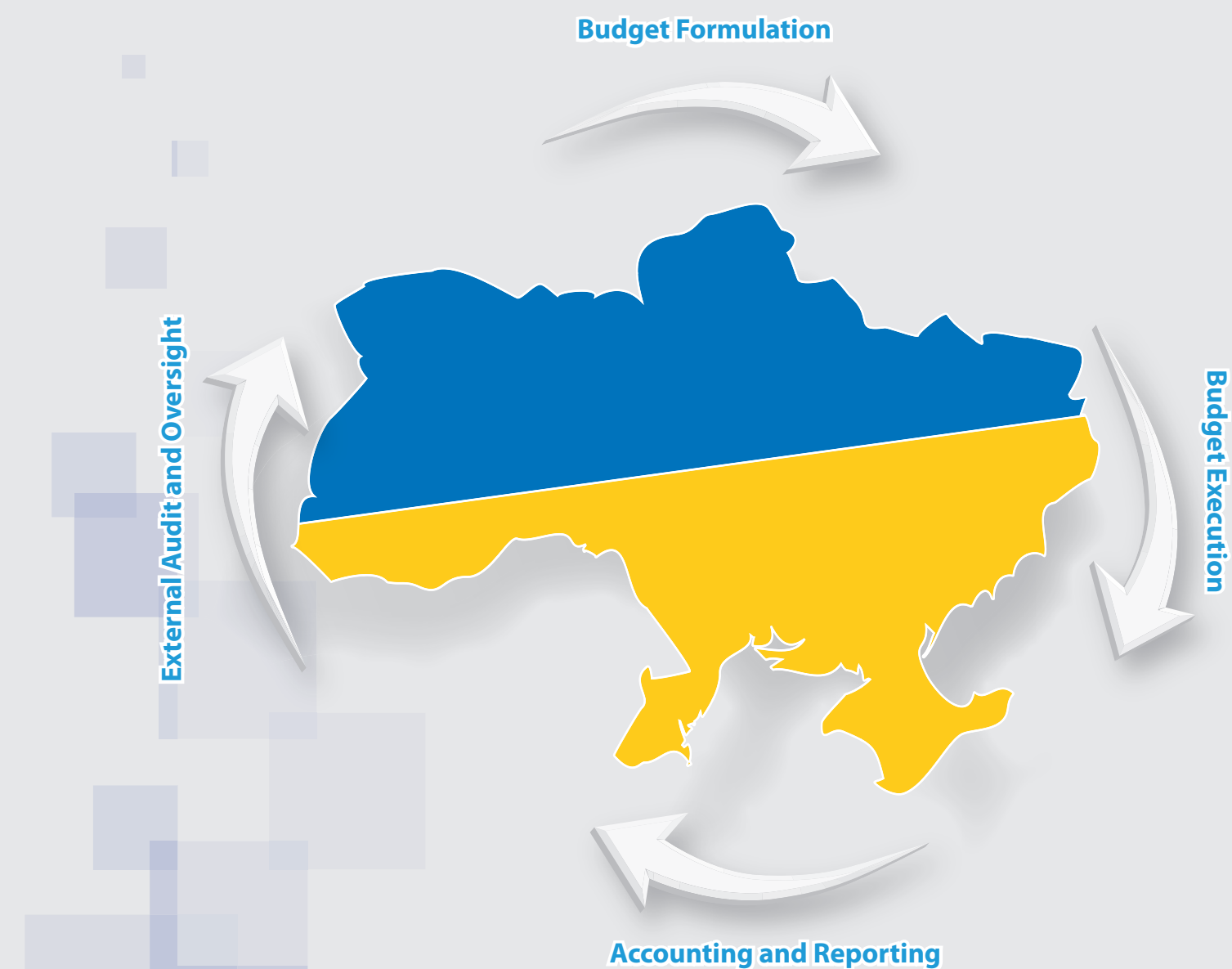




# UKRAINE

## Public Financial Management Performance Report



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## Public Financial Management Performance Report

2011



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## ABBREVIATIONS

<b>ACU</b>	Accounting Chamber of Ukraine	<b>MoE</b>	Ministry of Economy
<b>AMC</b>	Anti-monopoly Committee	<b>MoF</b>	Ministry of Finance
<b>BEEPS</b>	Business Environment and Enterprise Performance Survey	<b>NBU</b>	National Bank of Ukraine
<b>CCU</b>	Commercial Code of Ukraine	<b>NGO</b>	Non-governmental organization
<b>CHU</b>	Central Harmonisation Unit	<b>OBI</b>	Open Budget Index
<b>CoM</b>	Cabinet of Ministers	<b>OECD</b>	Organisation for Economic Cooperation and Development
<b>CPI</b>	Corruption Perceptions Indicator	<b>PFM</b>	Public Finance Modernization
<b>DPL</b>	Development Policy Loan	<b>PIFC</b>	Public Internal Financial Control
<b>ECA</b>	Europe and Central Asia	<b>PPL</b>	Public Procurement Law
<b>EU</b>	European Union	<b>PPP</b>	Public Private Partnership
<b>GDP</b>	Gross Domestic Product	<b>SCSU</b>	State Customs Service of Ukraine
<b>GFS</b>	Government Financial Statistics	<b>SFI</b>	State Financial Inspection
<b>IAS</b>	International Accounting Standards	<b>SIDA</b>	Swedish International Development Agency
<b>IBRD</b>	International Bank for Reconstruction and Development	<b>SOE</b>	State Owned Enterprise
<b>IIA</b>	International Institute of Internal Auditors	<b>STA</b>	State Tax Administration
<b>IMF</b>	International Monetary Fund	<b>STS</b>	State Tax Service
<b>IPSAS</b>	International Public Sector Accounting Standards	<b>STU</b>	State Treasury of Ukraine
<b>KRU</b>	Control and Revision Department	<b>TSA</b>	Treasury Single Account
<b>LMIC</b>	Lower Middle Income Country	<b>UMIC</b>	Upper Middle Income Countries
		<b>USAID</b>	United States Agency for International Development

## CURRENCY AND EQUIVALENT UNITS

(Exchange Rate Effective as of February 8, 2012)

Currency Unit = Hryvnia

UAH 1.00 = US\$ 0.125

US\$ 1.00 = UAH 8.00

## GOVERNMENT FISCAL YEAR

January 1 – December 31

## WEIGHT AND MEASURES

Metric System

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## OVERVIEW OF THE INDICATOR SET

A. PFM-OUT-TURNS: Credibility of the budget		Score 2010	Score 2005
PI-1	Aggregate expenditure out-turn compared to original approved budget	B	B
PI-2	Composition of expenditure out-turn compared to original approved budget	D+	B
PI-3	Aggregate revenue out-turn compared to original approved budget	B	A
PI-4	Stock and monitoring of expenditure payment arrears	B+	B+
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		Score 2010	Score 2005
PI-5	Classification of the budget	A	A
PI-6	Comprehensiveness of information included in budget documentation	A	A
PI-7	Extent of unreported government operations	D+	D+
PI-8	Transparency of inter-governmental fiscal relations	A	B+
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D+	D+
PI-10	Public access to key fiscal information	B	B
C. BUDGET CYCLE		Score 2010	Score 2005
C(i) Policy Based Budgeting			
PI-11	Orderliness and participation in the annual budget process	B	B+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+	C
C(ii) Predictability and Control in Budget Execution			
PI-13	Transparency of taxpayer obligations and liabilities	C+	C
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C	C
PI-15	Effectiveness in collection of tax payments	B+	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	C+	D+
PI-17	Recording and management of cash balances, debt and guarantees	B+	B
PI-18	Effectiveness of payroll controls	D+	D+
PI-19	Transparency, competition and complaints mechanisms in procurement	C+ <sup>1</sup>	D+
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	C+
PI-21	Effectiveness of internal audit	D+ <sup>2</sup>	C+

<sup>1</sup> Change in scoring methodology applies to 2010 assessment. This changed the basis for evaluation of the independent complaints mechanism resulting in a lower score for dimension iv of this indicator.

<sup>2</sup> The decrease in score results from a change in the application of the PEFA methodology since the previous assessment, not from a change in performance.

<b>C. BUDGET CYCLE</b>		<b>Score 2010</b>	<b>Score 2005</b>
<b>C(iii) Accounting, Recording and Reporting</b>			
PI-22	Timeliness and regularity of accounts reconciliation	<b>A</b>	<b>A</b>
PI-23	Availability of information on resources received by service delivery units	<b>B</b>	<b>B</b>
PI-24	Quality and timeliness of in-year budget reports	<b>A</b>	<b>C+</b>
PI-25	Quality and timeliness of annual financial statements	<b>C+</b>	<b>D+</b>
<b>C(iv) External Scrutiny and Audit</b>			
PI-26	Scope, nature and follow up of external audit	<b>D+</b>	<b>D+</b>
PI-27	Legislative scrutiny of the annual budget law	<b>C+</b>	<b>B+</b>
PI-28	Legislative scrutiny of external audit reports	<b>D+</b>	<b>D+</b>
<b>D. DONOR PRACTICES</b>		<b>Score 2010</b>	<b>Score 2005</b>
D-1	Predictability of Direct Budget Support	<b>D</b>	<b>NA</b>
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	<b>D</b>	<b>D</b>
D-3	Proportion of aid that is managed by use of national procedures	<b>C</b>	<b>D</b>

# SUMMARY ASSESSMENT

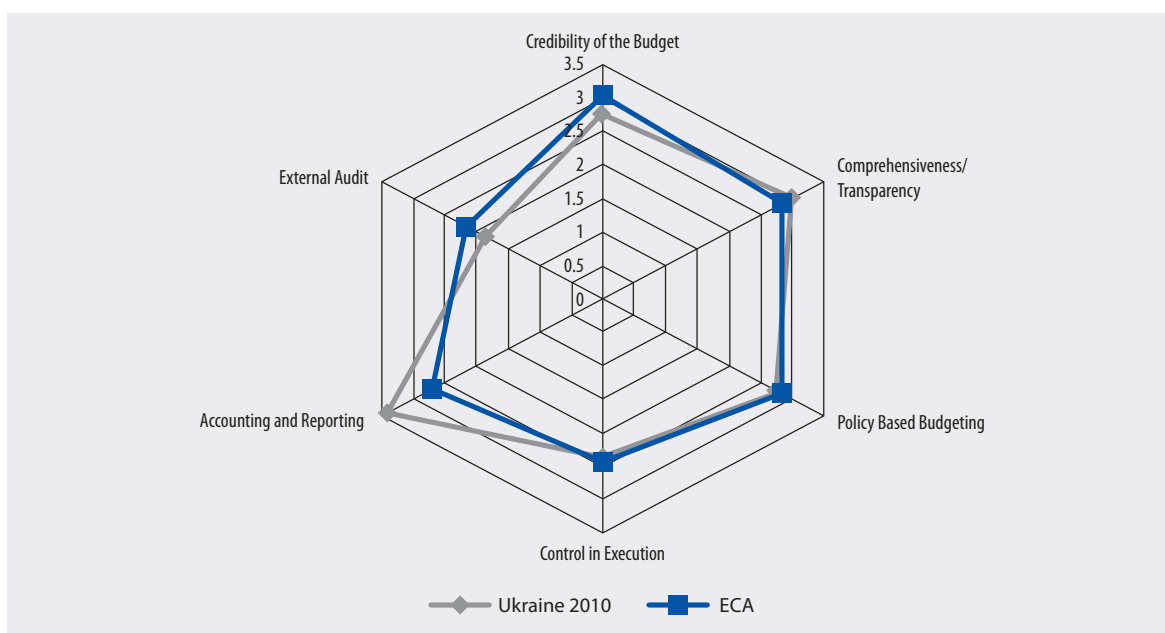
## I. Integrated Assessment of PFM Performance

Improvements to the PFM systems in Ukraine, introduced over the last decade, have contributed to improved fiscal management at an aggregate level and helped Ukraine to maintain budget discipline during a period of serious economic and political disturbance in 2008-9. A well established and transparent budget process, a strong centralized Treasury system and improved tax collection provided the foundations for this relatively good performance.

Since the last PEFA assessment was carried out in 2006 however, overall progress in implementing PFM reforms and improving performance has been slow. Steps forward in some important areas have been partly offset by backward steps elsewhere. A consistent driver of performance improvement has been expansion in the use of the Treasury system, supporting improvements in the availability of funds, in the management of cash balances, debt and commitments, and in the quality and timeliness of financial reporting. The financial and economic crisis, exacerbated by political uncertainty, largely accounts for the deterioration of performance in the areas of budget credibility and policy based budgeting, and the system appears to have recovered quickly. During this period Ukraine took some backward steps in accountability and oversight; limiting the scope of the ACU's work, and exempting the budgets of the four social funds from legislative oversight. Since 2010, the pace of reform has picked up significantly, with improvements to the budget process, tax administration and procurement, although the full potential benefit of these reforms has yet to be realized.

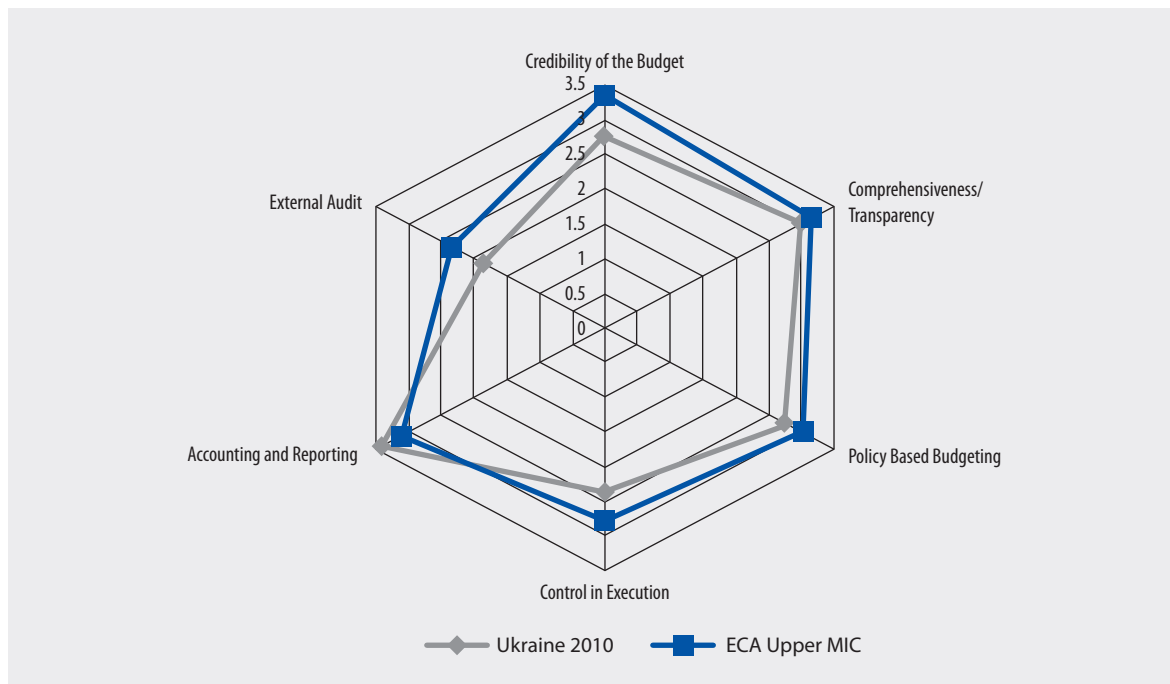
In most dimensions of performance Ukraine's PFM systems lags behind that of upper middle income countries in the Europe and Central Asia (ECA) region, although it is above the average of all countries in the region and, as a group ECA countries perform better than the global average. Figures 1 and 2 below compare Ukraine's performance across the six dimensions of PFM performance. This comparison is based on the most recent available PEFA assessments for other countries in the region.

Figure 1. Ukraine's PEFA Performance compared in ECA average<sup>3</sup>



<sup>3</sup> Comparison based on latest available PEFA scores for 15 other countries in the ECA region, completed between 2005 and 2010. These do not include any of the 10 EU member states in the region. All PEFA scores were converted to numerical values, assigning a value of 4 for A, 3.5 for B+, 3 for B, 2.5 for C+, 2 for C, 1.5 for D+ and 1 for D.



**Figure 2. Ukraine's PFM performance compared in ECA upper middle income average**

Source: PEFA Assessments.

**Persistent weak links in the overall PFM system prevent the good performance of other parts of the system leading to improved spending efficiency and better expenditure outcomes. These can be summarized as follows:**

- a) disconnects between policy objectives, recurrent budget allocations, and decisions on capital investment;
- b) a fragmented budget with large special purpose extra-budgetary funds for social insurance etc. that are not subject to the same standards of financial reporting and oversight by parliament and the accounts chamber;
- c) a target driven approach to revenue collection, has ensured high collection ratios but at significant cost to business and this has contributed to negative external perceptions of Ukraine as a place to do business;
- d) lack of focused oversight of state owned enterprises, that represent a large part of the economy and which have, from time to time, imposed significant burdens on the budget in the form of tax write offs and recapitalizations;
- e) flaws in the public procurement system (now corrected) that limited fair and open competition thereby undermining value for money;
- f) a strong focus on compliance checking, and the absence of a modern internal audit function, that results in a lack of attention to issues of system performance;
- g) limitations on the scope of work of the ACU, and the lack of a focus on external audit reports in the legislature, limits accountability for how public funds are used and reduces the incentives for ministers and officials to pay attention to performance and efficiency.

**Weaknesses in certain PFM practices have also contributed to negative perceptions of Ukraine as place to do business.** The most recent World Bank BEEPS survey and the Global Integrity Index indicate that poor practices in tax collection and procurement are a particular problem for Ukraine

(see Annex 2), which scores well below regional averages. The broad based Transparency International Corruption perceptions index also shows Ukraine on a divergent path from other Eastern European and former soviet states.

### ■ A. Credibility, Comprehensiveness and Transparency of the Budget

**Budget credibility in Ukraine has been adversely affected by the financial and economic crises, and by national elections, both of which coincided with the period (2008 to 2010) on which this assessment is based.** These temporary factors largely account for the overall deterioration in budget credibility observed since the previous assessment in 2006. The twin crises of 2008-9 resulted in an unexpectedly sharp decline in economic output (14.8%) and revenues. An IMF program helped to sustain some level of budget discipline at the aggregate level. In 2006 fluctuations in budget aggregates were the result of mid-year adjustments rather than external shocks, so it could be argued that underlying budget discipline has improved.

**Revenue shortfalls, compounded by the effects of the election and over-optimistic revenue projections, have resulted in major unplanned variances in sector expenditures,** including hikes in wages and pensions in 2010 and cuts in capital expenditure. Average variances between budget and actual expenditures across major categories rose to over 16% in 2009 and 2010. In spite of deep budget cuts Government has maintained good overall control over payment arrears. This has been helped by the establishment of a Treasury commitment control system, operating since 2008.

**Budget comprehensiveness is generally good and the budget classification system covers administrative, economic and program classifications.** The classification system is compliant with GFS 1986. In December 2011, the Ministry of Finance approved GFS 2001 compliant economic classification. The budget documents provide a comprehensive picture of the Government's fiscal position. It should be noted that using a more comprehensive range of measures the Open Budget Index (2010) rated Ukraine 19<sup>th</sup> in the world for the disclosure of budget information, suggesting a higher ranking than is given by the PEFA methodology.

**The existence of four important social insurance funds and other hypothecated funds, reported separately from the main budget, negatively affects budget transparency and the PEFA score.** The new Budget Code envisages that all extra budgetary funds report using IPSAS compliant national accounting standards starting 2013, which will be the first step towards consolidated reporting. Although they do not affect the PEFA score, the aggregate liabilities of SOEs also represent a potential threat to the budget in the form of contingent liabilities and write offs of tax arrears.

**Intergovernmental fiscal relations are regulated by clear formula that determines central government transfers to local governments,** based on the principle that all local governments should be able to meet their statutory responsibilities to provide public services. Over 90% of transfers are rule based, with the remainder financing investment projects or compensating for lost revenues. This system appears to offer little incentive for local governments to look for efficiency gains or savings. Use of the centralized Treasury system by local governments aids timely and consistent reporting of local government spending.

**The main source of fiscal risks from public sector entities outside central government comes from the activities of state owned enterprises, which represent around 18-20% of GDP.** Local governments' fiscal activities by contrast are more closely controlled with strict controls on borrowing and full visibility within the Treasury system. Oversight of SOEs is generally weak and fragmented across ministries, although the main concentration of quasi-fiscal activities is in the energy sector, which accounts for around 40% of the SOE sector. Attempts are being made to strengthen oversight in form of KRU audits. In 2006 KRU was mandated to carry out performance audits of SOEs and in 2009 it was mandated to monitor large and risky financial transactions undertaken by systemically important SOEs.

## ■ B. Policy Based Budgeting

**Ukraine has a well established budget process that allows for orderly consultations with line ministries and with the legislature.** Political events that took place during the period under review resulted in a significant delay in legislative approval of the budget in 2010 that accounts for the lower score compared to 2005. In 2011 budget preparation is back on track.

**The 2010 budget code which came into effect in the current financial year promises some further strengthening of the links between policy and the budget.** Previously government prepared medium term fiscal forecasts, but these did not translate into medium term allocations for programs or ministries and so had little influence on annual budgets. The 2010 Budget Code brings about important improvements, with the introduction of sector expenditure ceilings and a medium term perspective for long term public investment programs.

**The main weakness remains in capital budgeting practices;** project evaluation is not systematic or fully objective and recurrent cost implications are not always factored into the budget. That said some major programs such as Euro 2012 are now setting a much better example in terms of linking recurrent and capital costs.

## ■ C. Predictability and Control in Budget Execution

**Ukrainian PFM system is highly centralized with a focus on input controls.** The automated treasury system is applied across all units of government at all levels **and it does a satisfactory job in controlling expenditures and commitments.** The high degree of control is evidenced by good scores on most PEFA indicators related to Treasury control as well as internal audit sub-dimensions. The revenue, expenditure and treasury balances are known daily through the Treasury Single Account with the central bank consolidating most of the liquid resources of the government. The TSA provides real-time data about available cash balances. Procedures for controlling loans and guarantees are in place. The internal controls for non-salary expenditures are in place but could be strengthened further. According to SFI and ACU reports, there are some compliance failures however minor, related to stages prior to payment execution and occurring mostly outside of central government.

**The public procurement framework has improved markedly since the previous assessment and is now largely compliant with good international practice.** The public procurement law of 2005 was considerably deviating from the good practice and distorting public procurement system by privatizing core regulatory and oversight functions. This law was abolished in 2008 and the new law was drafted in consultations with the European Commission and the World Bank and adopted in June 2010. The deficiency of the current law is related to vague definition of the rationale for use of non-competitive methods leading to frequent use of single source procedure. Attempts to further improve the law and strengthen accountability for using non-competitive procurement methods are underway and the draft legislation is being considered by the Parliament.

**A revenue target approach to revenue administration has not helped the business climate or trade facilitation. However, some major improvements took place recently;** the approval of the Tax Code in 2010 created a basis for comprehensive, unified tax legislation in Ukraine, replacing numerous legislative acts governing the area of tax policy and tax administration before. Access by taxpayers and importers/exporters to information has improved due to the introduction of new technology. These include establishment of Call Centers by the State Tax Service, and expansion of e-filing of tax returns. Information exchange between Treasury, Tax and Customs Services has improved using procedures established under the joint order of these agencies.

**Although the elements of a risk-based approach to inspection are increasingly utilized, the major problem remains the policy of revenue targeting, which results in high rates of customs inspection of imported cargo as well as an extremely high frequency of audit of VAT refunds and tax audits in general.** Until recently 100% of VAT refund claims were audited. Over the last 2 years, significant positive steps have been taken using a risk based system for planned audits, resulting

in a gradual reduction of the number of audits under this category. However, unplanned audits have proliferated in 2010. High levels of revenue audits in Ukraine are a burden on business, particularly small and medium size enterprises. More audits also mean more opportunities for corruption.

#### ■ D. Accounting, Recording and Reporting

**The Treasury Single Account (TSA), which was established under the first phase of PFM reforms, underpins the strong financial reporting and cash management practices in government.** Coverage of the TSA is comprehensive, and combined with the improved budget classification system, enables the treasury to produce good quality, timely in-year reports on budget execution and cash flows.

**Treasury practices have further improved since the 2006 assessment.** Treasury has been able to reduce the time produce in-year budget reports while at the same time, through the improvements in budget classification, generating reports with considerably more detail than before. Reports are generated for 3 different classification structures (administrative, economic and functional) and for the different tiers of government (central government, local government).

**Extra-budgetary Funds, such as the pension fund, road fund and social funds have uneven treatment in government budgetary and financial reports.** Some loans are treated as revenue (for example in the case of UkrAvtdor), while the amortization of loans is treated as expenditure. These treatments are in direct contradiction to the international financial reporting standards definition of revenue recognition (IAS 18) and borrowing costs (IAS 23). While consolidated budget reports (including budget reports on Pensions) are prepared within the prescribed time period, reports on three social funds are substantially delayed.

#### ■ E. External Scrutiny and Audit

**The Accounting Chamber of Ukraine (ACU) is the country's Supreme Audit Institution. It conducts an annual financial audit of the government's budget execution statement.** This annual audit is primarily a compliance review and does not offer an audit opinion on the government's financial position or financial statements and does not include report on the reliability of government systems to produce such statements. It does not therefore meet international standards.

**The mandate of ACU is limited compared to other SAIs.** The scope of the annual audit of the government's budget statement omits audit of government revenues (following a decision of the Constitutional Court of Ukraine in September 2010), the activities of local governments and extra-budgetary funds. At the time the assessment was carried out the head of the Accounting Chamber had completed his two-term mandate, but a new Head had not been appointed by the Parliament.

**The Accounting Chamber of Ukraine (ACU) has made some progress over the last several years in revising its approach to the audit of public expenditure.** The Accounting Chamber regularly executes performance audits (known as 'Efficiency Audits') as part of its annual work program and these audits have enhanced the oversight of public expenditure programs and the allocation of budget resources. However, the methodology could benefit from further refinement and alignment with INTOSAI standards and it is unclear what, if any, positive impact this new audit approach has on government expenditure policies.

**Ukraine's Parliament does not have a dedicated audit committee and tracking of hearings by parliamentary committees, and government responses to issues raised by parliament, is not systematic.** The Budget Committee and other (sector) committees share responsibility for reviewing audit reports based on the subject matter, but the reviewers were unable to obtain clear evidence of the extent to which audit reports were considered in detail by the relevant committees or whether officials of the relevant ministries participated.

## II. Prospects for Improvement

**Further improvements to Ukraine's PFM systems can play an important part in delivering Ukraine's objectives in the areas of improved public service delivery, a better climate for business and investment and improved control of corruption, while maintaining fiscal discipline.** Based on this assessment of performance and a review of ongoing government reform initiatives a number of issues stand out as requiring government attention as part of Government's ongoing efforts to strengthen PFM systems and performance:

- a) Implementation of medium-term budgeting and improvements in capital budgeting
- b) Re-balancing the objectives of revenue collection agencies, placing more emphasis on taxpayer compliance and less on revenue collection targets
- c) Implementation and monitoring of the new public procurement framework to ensure full effectiveness
- d) Improving management and oversight of fiscal risks arising from the activities of SOEs
- e) Developing a modern internal audit function that focuses more attention on improving controls and efficiency
- f) Strengthening the mandate of the supreme audit institution (ACU) by removing current limitations on its oversight role that are inconsistent with international good practice
- g) Strengthening the legislature's role in scrutiny and follow up of audit findings.

**Medium term budgeting elements are present and evolving but the link between policy and budget continues to be missing.** Some medium-term elements have been present for several years including medium term fiscal framework and budget ceilings for line ministries. More recently the new Budget Code introduced multi-year appropriations for investment programs. However, links between the medium term estimates with policy, strategies, and the relevant objectives to be achieved are largely absent. According to article 21 of the new code, budget requests by line ministries must cover not only the year for which the budget is prepared but also the following two years, and the cabinet of ministers must make a decision on medium-term revenue and spending forecasts one month after the adoption of the budget law by Parliament. What is important is to ensure that ceilings are respected going forward and any changes introduced in the following years are based on clear rules and properly justified.

**A public procurement legislative framework has been approved that is largely compliant with international practice, but implementation remains a challenge.** The key elements that are still required to ensure a transparent, efficient and competitive public procurement process in Ukraine are: (1) approving bylaws and regulations to make the system effective, including for utility companies and natural monopolies; (2) putting in place a monitoring framework to evaluate the performance of the system, including publicly available measurable outcomes (such as the ratio of single source procurement to total government procurement) to allow civil society to monitor the processes; (3) further approximation of the public procurement framework with EU Directives and investment in capacity building in beneficiary agencies to implement the new legislation.

**The customs and tax services need to develop a compliance oriented approach and systems.** Both tax and customs services are strongly driven by revenue performance targets. This encourages arbitrary behavior by officials, including increased frequency of customs inspections and tax audits beyond that justified by the actual risks, and assessments that often ignore the underlying documentation. This contributes to negative perceptions of the behavior of both services, as well as creating scope for corrupt practices and delays to importation of goods. Although substantial progress has been made in updating legislation and improving systems and procedures in the tax service, customs is lagging behind in many areas. Future progress will require implementation of new customs legislation and improvement



in business processes, reducing the level of discretion that can be exercised by officers. Tax appeals and VAT refund processes function poorly and both services need to pursue a change in management approach and philosophy that makes taxpayer compliance the primary goal rather than maximization of revenue.

**SOE oversight is weak and fragmented and requires considerable streamlining and strengthening.**

Absence of a comprehensive registry of all SOEs operating in Ukraine poses difficulties in obtaining data and thus taking decisions in regards to SOE operations. Improvements in transparency and accountability of SOEs can be achieved by requiring publication of operating objectives, including non-commercial objectives, annual independent audit and revising performance measurement framework to incorporate standard measures and methodologies for the assessment of SOE performance.

**Despite the on-going efforts, much work remains to be done to prepare line ministries and agencies to execute and record transactions on the basis of new accounting standards.**

The public sector accounting reform strategy is anticipated to further improve the quality and comprehensiveness of government financial reporting. However, the full impact of IPSAS Accrual implementation will not materialize in the immediate/short term as this reform will result in the introduction of a completely new and complex accounting regime for the public sector in Ukraine. In addition, work is also needed to prepare functional units in the Treasury and Ministry of Finance so that government financial statements can be prepared on the basis of the new accrual standards. The government is on track to develop and approve 19 new public sector accounting standards by December 2011 and the final 3 standards will be approved in 2012; the government anticipates the full set of standards to come into effect as of January 2013.

**Internal and external audit functions still face major challenges in providing an effective oversight role.**

The internal audit reform efforts have intensified in 2011 and internal audit units were established in almost all central government agencies. Creation of an effective internal audit function, in line with international standards, will require a sustained program of capacity building, and the respective roles and functions of the State Financial Inspection and Internal Audit would need to be redefined. The independence of the ACU needs to be re-affirmed and its mandate broadened to include local budgets and government revenues. To match international good practices senior appointments should be apolitical. The ACU's auditing standards and methodologies also need further work to align them with international standards.

**More intensive and systematic legislative scrutiny of external audit reports could ensure greater accountability of public officials and promote more efficient use of public funds.**

Although the ACU submits its reports to Parliament, their consideration does not appear to be systematic or well documented. Parliament should strengthen the coordination function of the sub-committee responsible for external audit or establish a separate committee dedicated to scrutiny of public accounts and audit reports. Systematic monitoring and follow up on actions taken by government departments to address issues raised in audit reports is also good practice. Similar committees in some other countries also use televised public hearings and press briefings to improve the visibility and impact of their work. The Chamber has yet to develop a medium-to-long term institutional development strategy which would introduce modern training and professional development programs, upgrade audit methodology and techniques.

**This assessment provides an opportunity to take stock of the results of the current set of PFM reform initiatives and to make adjustments where necessary.**

Reorientation of the PFM system from an input-driven traditional mode to a more result-oriented system, greater involvement of civil society and better evaluation and feedback mechanisms, in the form of modern internal and external audit and accountability for results can help to improve the management of public funds and the quality of services. Continued improvements in the efficiency and integrity of public procurement practices; and in tax and customs administration can reduce corruption, improve fiscal balance and contribute to a better environment for doing business in Ukraine.

# 1. INTRODUCTION

## ■ A. Objectives

1.1 **The 2011 PEFA Assessment is intended to assess changes in PFM system performance between FY 2005 and FY 2010, and to inform the future direction of Government's public finance management reform program.** More specifically, this report (i) provides an updated overview of PFM performance using the PEFA Performance Measurement Framework; (ii) establishes and explains changes in performance compared to the results found during the previous assessment; (iii) reviews Ukraine's PFM performance relative to other countries and related benchmarks and (iv) assesses the impact of the findings and their implications for the ongoing reform program of the Government.

## ■ B. Methodology

1.2 **The PFM Performance Report was prepared by a team of World Bank staff and EU financed consultants.** The assessment team leaders were Ivor Beazley (World Bank) and Oleksiy Balabushko (World Bank). Team members were Sevtlana Budagovskaya (World Bank), Sebastian Dubost (EC Consultant), Yiannis Hadziyiannakis (EC Consultant), Yoko Kagawa (World Bank), Munawer Khwaja (World Bank), Chris Page (EC consultant), Ruslan Piontkivsky (World Bank), Pablo Saavedra (World Bank), Irina Shmeliova (World Bank), Yulia Snizhko (World Bank), Rajeev Swami (World Bank), and John Wiggins (EC Consultant). Field work was carried out between April and November 2011, with fact finding missions by non-Ukraine based team members in April 2011 and in May-June 2011.

1.3 **The analysis for the 2011 performance report is based on processes and data reported for the year 2010, the last year for which complete information was available at the time the assessment was prepared in 2011. For some indicators the assessment included earlier year's data , as required by the PEFA methodology.** 2010 performance was compared with the 2005 data (used to prepare the 2006 PEFA report), and the report describes the developments that led to changes in PEFA scores. In order to provide a complete and up-to date picture as at the time of report preparation, the assessment also describes significant developments that took place in 2011 although 2011 data was not used for the purposes of scoring PEFA indicators. The basic approach followed in preparing the PEFA assessment was as follows:

- Collect and review existing primary information sources, including relevant laws, administrative procedures and financial and other performance data.
- Collect additional information and conduct interviews with officials during the course of various project missions and specific meetings to complete the initial assessment.
- Consult with government agencies and other donors to confirm the team's understanding of the performance information and discuss the PEFA ratings.

Many team members drew on their current knowledge, gained through ongoing involvement in supporting projects and providing advisory support to Government on public finance management issues. These include the Public Finance Management Reform Project, the State Tax Service Modernization Project and a trust fund on capital budgeting.

1.4 **Detailed consultations were held with other donors during the development of both the concept note for the assessment and preparation of the report itself.** These donors, which have strong interest in PFM include the International Monetary Fund (IMF), which is providing budget support and technical assistance on PFM, the EC, which is providing budget support across a broad range of sectors, and the Swedish International Development Agency (SIDA), which is advising the Ministry of Finance on the co-ordination and reporting of donor financing.

1.5 **The Government was closely involved in the PEFA assessment process.** The repeat PEFA assessment was planned as a tool for assessing progress in PFM reforms, linked to the World Bank PFM Modernization Project. The Government supported the process through provision of data, interviews and validation of the draft results of the PEFA assessment. The Ministry of Finance was the main counterpart for the report. Consultations were also held with Secretariat to the Parliament, Accounts Chamber of Ukraine, the State Taxation and Customs Services, the State Treasury Service, the State Financial Inspectorate, the Ministry of Economy and the Anti-Monopoly Committee.

1.6 **The PEFA repeat assessment took account of recent analytical work on PFM,** including Public Finance Reviews (2006, 2008), an OECD/SIGMA Public Finance Assessment (2011), an OECD Budget Review (2011) and an IMF assessment of Medium Term Budgeting (2011). These reports tend to analyze the progress made in key areas of public financial management as part of ongoing efforts and suggest a menu of policy reforms. In contrast, the PEFA assessment applies a comprehensive, standardized and indicator driven methodology that focuses on measuring the aggregate outcome of PFM systems performance.

1.7 **Direction and quality assurance were provided by William Dorotinsky (Manager, Public Sector, Europe and Central Asia, World Bank), Andreas Papadopoulos (European Union) and Martin Raiser (Country Director Ukraine, World Bank).** Additional peer review comments on the concept note and the draft report were provided by the European Commission experts (DG Budget, DEVCO and ECFINC), by Frans Ronsholt (PEFA Secretariat), Gosta Ljungman (International Monetary Fund) and Sanjay N. Vani (World Bank). [The draft report findings were shared with the Ukraine Government and other stakeholders and their feedback is reflected in the performance assessment].

## ■ C. Scope

1.8 **The scope of the repeat assessment was confined primarily to the Central Government.** This comprises Line Ministries, Services and Agencies. To the extent that they raise fiscal risks to the central budget the review covers the activities of SOEs and local governments, but it does not include an assessment of PFM systems and performance at sub-national level. Aspects of decentralization are covered by indicators: PI 8 (Framework for inter government fiscal relations); PI 9 (Fiscal risks arising from sub national governments); and PI 23 (Availability of information on resources at front line service delivery units).

1.9 **The assessment looked at Ukraine's progress in PFM reform relative to other countries and also relative to other international benchmarks on governance and public finance management.** In order to provide a better perspective on Ukraine's performance the team analyzed Ukraine's PEFA performance relative to a set of benchmark countries and compared its progress (2005 to 2010) to other countries that have undertaken repeat PEFA assessments over a similar time period (Annex 2). In addition the team reviewed available governance indicators linked to PFM, including Business Environment and Enterprise Performance Survey (BEEPS) index, Open Budget Index and Global Integrity Index in order to triangulate the findings and assess the impact of changes in PFM on broader perceptions of governance and quality of service.



## 2. COUNTRY BACKGROUND

### ■ A. Economic Situation

**2.1 Ukraine is an eastern European country with a population of approximately 46 million.** While transition from the socialist system started in the early 1990s and much has been done in shifting to a market economy, there are many remnants of the previous approach even after 20 years of transition.

**2.2 Ukraine was an average growth performer in a fast growing region, with GDP growth averaging 7 percent between 2000 and 2008.** Growth helped to significantly reduce poverty in the country, despite the setback in the context of the downturn. The poverty and vulnerability headcount index fell steadily from 46.9 percent in 2002 to just 12.3 percent in 2007 (measured by the USD 5 in Purchasing Power Parities poverty line). Growth over these years was primarily driven by external and temporary factors as opposed to the structural changes in the economy.

**2.3 As the financial crisis unfolded Ukraine's economy contracted by 15 percent in 2009, exposing its underlying macroeconomic and structural vulnerabilities.** These included: (i) short maturity periods of the fast growing private sector external debt; (ii) banking sector vulnerabilities associated with the rapid loan growth supported by predominantly external funding and weak regulatory and supervision controls; (iii) volatile terms of trade and lack of diversification in external demand (mainly related to the steel and heavy industry sectors on the export side and the gas sector on the import side), (iv) expansionary fiscal policies in the context of problematic expenditure and revenue structures; (v) weak competition and ability to diversify and generate higher value added products; and (vi) an overall burdensome regulatory environment and large government footprint that hamper private sector development.

**2.4 Ukraine's economy registered 4.1 percent growth in 2010 on the back of moderate improvements in external and domestic demand and the low base of 2009.** Private consumption expanded 5.8 percent in 2010, while fixed investment grew 3.2 percent. Changes in inventories accounted for 1.3 percent of GDP, leading to real growth of gross investment of 18.7 percent. In contrast to 2009, the contribution of net exports to GDP growth turned negative in 2010, as real imports growth of 11.5 percent outpaced export expansion of 4.6 percent. The Table 1 below displays key macroeconomic indicators. The general government budget comprises: (i) the state budget; (ii) all local government budgets; and (iii), if not already included in (i), the budgets of the extra budgetary funds, including the Pension, Employment, Social Insurance for Temporary Disability, State Material Reserve, Occupational Accident and Sickness Insurance, State Property Fund, and the Road Fund (UkrAvtoDor).

**2.5 As a result of the insufficient structural transformation and impact of the economic crisis, Ukraine now faces substantial fiscal pressures that threaten economic stability and growth.** These include large and growing infrastructure investment needs (estimated by the World Bank's Public Finance Review (2006) at USD 100 billion between 2006 and 2015); the demographic problem of an ageing population and an unreformed pension system; growing public and publicly guaranteed debt; and high average tax burden and high marginal rates of direct tax coupled with an onerous revenue administration system.

**2.6 Fiscal policy has concentrated on the gradual reduction of fiscal deficits.** The new IMF supported program (approved in July 2010) set the consolidated general government deficit for 2010 at 5.5 percent of GDP and 3.5 percent in 2011. In addition, the state-owned gas monopoly Naftogaz was expected to run at 1 percent of GDP in 2010 and balance its finances in 2011. While the overall deficit target was met, there were slippages in the performance of Naftogaz leading to an overshoot of the deficit target.

**Table 1. Key Macroeconomic Indicators**

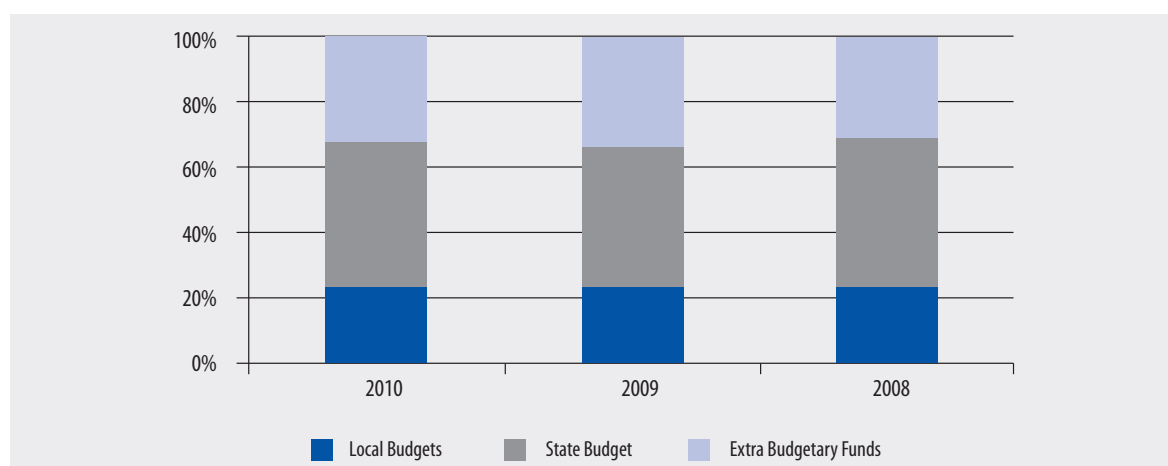
	2005	2006	2007	2008	2009	2010
Nominal GDP, UAH billion	441.5	544.2	720.7	948.1	913.3	1082.6
Real GDP, % change	2.7	7.3	7.9	2.3	-14.8	4.1
Consumption, % change	15.7	12.4	13.6	9.0	-12.2	5.9
Fixed Investment, % change	3.9	21.2	23.9	1.6	-50.5	4.9
Export, % change	-12.2	-5.6	3.3	5.2	-22.0	3.9
Import, % change	6.4	6.8	21.5	17.1	-38.9	11.3
GDP deflator, % change	24.6	14.8	22.7	29.2	13.0	13.8
CPI, % change eop	10.3	11.6	16.6	22.3	12.3	9.1
Current Account Balance, % GDP	2.9	-1.5	-3.7	-7.0	-1.5	-2.1
Terms of Trade, % change	8.3	4.9	9.8	6.1	-6.8	4.4
Budget revenues, % GDP	41.8	43.7	42.3	43.9	40.7	43.2
Budget expenditures, % GDP	44.1	45.1	44.3	47.0	49.4	50.6
Fiscal balance (with Naftogaz, w/o bank recap), % GDP	-2.3	-1.3	-2.0	-3.1	-8.7	-7.4
External debt, % GDP	45.3	50.4	58.6	83.6	90.8	85.0
Public and Guaranteed Debt, % GDP	17.7	14.8	12.3	20.0	34.8	39.5

**Source:** State Statistics Service, Treasury Execution Reports.

## ■ B. Structure of Government and the State Budget

2.7 **Ukraine has a multitier Government system.** Central Government comprises Parliament, President, Cabinet of Ministers and the Judiciary (Supreme Court). After the administrative reform launched by the President in December 2010 aimed at downsizing and streamlining of the executive power bodies there are 16 ministries, 53 central government bodies that are subordinated to respective ministries and 3 special status government bodies independent from any ministry (State Property Fund, Anti Monopoly Committee and State TV and Radio Committee). The Accounting Chamber is a Supreme Audit Institution reporting to the Parliament. Local government comprises 24 oblasts, two cities of national significance (Kyiv and Sebastopol) and the Autonomous Republic of Crimea as a first tier. The second tier comprises 488 rayons and 177 municipalities. The third tier consists of over 12 thousand local governments (including villages and townships).

2.8 **The Central Government spending constitutes less than half of the General Government Budget; another quarter comes from the local budgets, while the rest is consumed by the social funds including pensions.** As a result of the demographic trends, economic crisis and populist fiscal policies the share of Pension Fund, Social Insurance Fund for Temporary Disability, Labor Accident and Occupational Disability Insurance Fund, and Unemployment Fund has grown considerably and now accounts for over 30% of total spending. The local budgets' share is stable at slightly less than 25 percent.

**Figure 3. Structure of General Government Expenditures**

**Source:** Ukrainian Authorities, Bank staff estimates.

2.9 Central Government Budget fiscal performance is represented in the table below and shows considerable government share in the economy.

**Table 2. Central Government Budget (% of GDP)**

	2007	2008	2009	2010
Total revenue	23.0	24.4	23.0	22.2
-Tax revenue	16.2	17.7	16.3	15.4
-Non-tax, capital revenue and grants	5.8	5.6	7.2	6.1
Total expenditure	24.2	25.4	26.5	28.0
-Non-interest expenditure	23.7	25.0	25.5	26.5
-Interest expenditure	0.5	0.5	1.1	1.5
Aggregate deficit (including grants)	-1.2	-1.0	-3.6	-5.8
Primary deficit	-0.6	-0.6	-2.5	-4.3
Net financing	1.4	1.3	3.9	5.9

**Source:** State Statistics Service, Treasury Execution Reports.

2.10 The allocation of resources has changed considerably over the last 5 years. The most prominent trends have been the increasing share of social transfers and the falling share of capital expenditures in overall spending. This trend can be tracked in both allocations by sector and allocations by economic classification. Another trend has been increasing interest payments, attributable to increased borrowing by Ukraine during the crisis. The most worrying trend is the diminishing share of public investments that fell from 15 percent to 4 percent of overall central government expenditures between 2007 and 2009 with slight upswing in 2010 to 7 percent. Tables 3 and 4 below summarize allocations of central government budget.

**Table 3. Actual Budgetary Allocations by Sector  
(% of total expenditure)**

Expenditure Item	2007	2008	2009	2010
General functions of public administrations	9.7	9	10.3	11.4
Defense	5.4	4.9	4	3.7
Civil order, security and courts	10.5	10.3	10	9.4
Environmental protection	1.1	0.9	0.7	0.8
Housing and communal	0.4	0.2	0.1	0.3
Healthcare	3.6	3.1	3.1	2.9
Spiritual and physical development	1.1	1.2	1.3	1.7
Education	8.7	8.9	9.9	9.5
Social protection and social care	16.8	21	21.2	22.8
Economic Activities	17.1	16	13.7	11.9
<i>Agriculture, forestry, fishery and hunting</i>	4.6	3.9	2.5	2.4
<i>Energy fuel complex</i>	4.1	6.4	4.9	4.0
<i>Transport</i>	6.6	4.3	4.8	4.2
Interbudgetary transfers	25.6	24.5	25.7	25.6
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Source:** Treasury Execution Reports.

**Table 4. Actual Budgetary Allocations by Economic Classification**  
(% total expenditure)

Expenditure Item	2007	2008	2009	2010
Current expenditures	85	89	96	93
-Wages and salaries	19	18	19	17
-Goods and services	3	3	3	3
-Interest payments	2	2	4	5
-Transfers	62	67	70	68
Capital expenditures	15	11	4	7
-Capital transfers	10	7	2	5
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Treasury Execution Reports.

### ■ C. Legal and Institutional Framework for PFM

2.11 **PFM roles and responsibilities in Ukraine are clearly defined and assigned.** The roles are assigned under several pieces of legislation including:

- Constitution of Ukraine (establishing the roles and responsibilities of the executive, judiciary, and legislature including in budgeting process),
- Budget Code (regulating all stages of budget process including planning, approval, execution, audit),
- Tax Code (setting tax policy and regulating issues of tax administration),
- Customs Code (setting customs policy and regulating issues of customs administration),
- Law on Accounting Chamber (setting responsibilities and process for external audit),
- Law on Internal Financial Control (regulating internal audit and control and roles of State Financial Inspection and government agencies in this process),
- Public Procurement Law (regulating procurement process and defining roles and responsibilities of different actors such as procuring entity, authorized agency and complaint body),

These are supplemented by normative documents approving statutes of government bodies. The Annex 3 lists full set of normative acts used for carrying out the PEFA assessment.

The budgeting process in Ukraine is split between the executive that prepares and executes State Budget and legislature in charge of approving of the budget, introducing amendments, and controlling execution of the State Budget of Ukraine through the Accounting Chamber of Ukraine. The key actors and their major tasks are summarized in the Table 5.

**Table 5. Central PFM Organizations and Role in Ukraine**

Organization	Major Tasks	Comments on Key Functions
Ministry of Finance	Budget Formulation and Execution Debt Management Revenue Policy	Following Presidential Decrees in December 2010 and early 2011, the State Financial Inspection, Treasury Service, State Tax Service and State Customs Service are subordinated to the Ministry of Finance
-State Financial Inspection	Internal Inspection Service	Centralized, government wide internal inspection focusing on compliance Each ministry has an internal inspection unit The performance audit function is being developed and performance audits of budget programs are carried out

Organization	Major Tasks	Comments on Key Functions
-Treasury Service	Treasury servicing of the budget expenditures and revenues as well as extra budgetary funds	Cash management function not developed
-State Tax Service	Tax collection	Administers tax policy while MoF central apparatus sets policy
State Customs Service	Customs enforcement and collection	Administers customs policy while MoF central apparatus sets policy
Ministry of Economy	Macroeconomic forecasting National economic policy Multi-year planning Capital project selection Procurement (monitoring and regulatory) SOE efficiency review Public Private Partnership	Multiyear planning is not integrated into the budgeting process SOE review not developed
Accounting Chamber	External Audit	Supreme Audit Institution  Can only audit expenditures of the State Budget. State revenues, extra-budgetary funds, state owned enterprises and local governments are outside its remit. <sup>4</sup>

**2.12 Other organizations also have roles in the PFM system but these are narrower in scope.** The State Statistical Service plays a role in fiscal data collection and dissemination. The State Property Fund is in charge of management oversight of non-unitary SOEs. The Anti-monopoly Committee has a compliance review role in relation to public procurement.

**2.13 Spending ministries have a critical role in PFM but less emphasis was placed on developing their capacity in line with the PFM responsibilities.** Spending ministries tasks comprise of strategic and multiyear planning, budget formulation, capital project preparation and management, procurement, budget management, asset management, SOE oversight and internal controls. These areas will require considerable attention in future, given the introduction of multiyear budgeting in the Budget Code, plans to introduce a system of capital project selection and evaluation, and the development of public private partnerships.

**2.14 Coordination between Ministries remains an issue.** One of the most problematic areas is coordination between Ministry of Economy and Ministry of Finance on issues of strategic planning and capital budgeting. These processes are not well linked leading to the problems such as high under-execution rate of capital projects.

**2.15 Recently a major step was taken to integrate some of the PFM functions.** A December 2010 Presidential Decree (Presidential Decree #1085/2010) reorganized the system of executive bodies subordinating State Tax Service and State Customs Service to the Ministry of Finance in addition to the already subordinated State Financial Inspection (former KRU) and State Treasury Service.

**2.16 The PFM legal framework is evolving and many legislative and policy initiatives are underway.** Recently the Tax Code was approved after years of consultations and discussions, a new edition of the Budget Code introduced a multi-year approach to the budgeting process, and amendments to the Customs Code were approved in 2011 and will become effective in course of 2012. Several major strategies, discussed in the following section envisage further reforms in key PFM areas.

<sup>4</sup> See the paragraph 3.161 for discussion on limitations of supreme audit institution mandate.

## ■ D. PFM Reform Program

2.17 **The Government of Ukraine has recognized consistently pursued improvements in PFM processes and performance since the 1990s.** The Government's PFM reform between 2006 and 2010 was developed over time in a series of strategic documents. The major initiatives have been; the Concept of PIFC Development until 2017 (2005); PFM System Modernization Strategy (2007); Strategy for Public Sector Accounting Reform for 2007-2015 approved (2007), and the Concept of Local Budget reform until 2011 (2007). More recently the Economic Reform Program of the President of Ukraine (2010) has brought together PFM activities within one of the major pillars of the program. It covers many areas that are already under implementation such as local budget reform, debt reform, budget reform, internal audit reform plus tax and customs codes, capital budgeting, public asset management and strategic planning reforms. These reform programs have been implemented with varying levels of speed and effectiveness as described in the relevant sections of the performance report.

2.18 **Institutionally PFM reforms are coordinated by the Ministry of Finance as the main body in the area within the executive.** At the same time while central PFM roles are clearly defined, some functions remain fragmented among several actors. Coordination across the agencies has posed problems. Most vivid example is coordination on macroeconomic forecasting, medium term planning and budgeting and capital budgeting which is split between the Ministry of Finance and Ministry of Economic Development and Trade. The SOE oversight is split between multiple actors including State Property Fund, MoED, MoF, and line ministries. The recent encouraging development following the Presidential Administrative Reform launched in December 2010 is strengthening the role of the MoF by explicitly subordinating not only Treasury and SFI but also both revenue services. Such centralization is likely to improve coordination and reform implementation in the medium run.

2.19 **A number of international development agencies are involved in supporting the PFM reform program** through investment projects and technical assistance. The Ministry of Finance is currently implementing two World Bank-financed projects; a Public Finance Modernization Project that supports the development of an integrated financial management information system and the improvement of business processes in the Ministry of Finance, Treasury and SFI; and a State Tax Service Modernization Project that is working to improve the efficiency of tax administration and foster voluntary compliance. Technical assistance is being provided on public debt management and budget forecasting (EU funded twinning arrangement), strengthening municipal finance management (USAID), debt management (US Treasury), management and recording of development assistance (SIDA), and capital budgeting (World Bank). The PFM agenda was also part of the World Bank development policy lending program, supporting reforms in capital budgeting, public private partnerships, tax administration and policy, as well as overall macrofiscal management.



## 3. PFM ASSESSMENT

3.1 This section of the report provides a detailed assessment of each of the 28 PEFA performance indicators and the three donor performance indicators. For each indicator an assessment has been made of current performance. This is followed by a comparison with 2005 performance including an explanation of the main developments that underlie the changes in performance. Finally any noteworthy developments in 2011, that may impact future performances, are captured under a separate heading. A quick reference table, setting out the scores and supporting evidence by sub-indicator, is provided at Annex 1.

### ■ A. Credibility of the Budget

#### PI-1. Aggregate Expenditure out-turn Compared to Original Approved Budget

Indicator PI-1	2010 Assessment	2005 Assessment
Aggregate expenditure out-turn compared to original approved budget	B	B

#### 2010 Assessment

3.2 Actual aggregate expenditures varied from planned figures in 2008 and 2009 mainly as a consequence of the external shocks suffered by the economy. Aggregate expenditures varied by 4.6% in 2008 and 11.6% in 2009 (i.e., outturns below planned figures). The data table supporting the scoring could be found in the Table 5.2, Annex 5. The functional breakdown was used to calculate variation. Economic breakdown numbers refer to adjusted planned figures while functional refers to original plan. Up to mid-2008, the widening of the current account deficit was financed by large inflows of foreign borrowing and foreign direct investment (FDI), but these flows stopped suddenly in the last quarter of 2008. Significant terms of trade gains also turned negative as steel prices plummeted, placing pressures on the revenue side in the second half of 2008. Inflation intensified driven by higher food and energy prices. To control demand, in the spring of 2008 the government started a de-facto fiscal tightening through under-execution. As the crisis unfolded, 2009 experienced a drop of 15 percent in GDP-- well below the government's expectations. The drop in output encompassed a collapse in revenues and thus a needed (and significant) realignment on the expenditure side.

3.3 In 2010, hikes in pensions and wages early in the year were to some extent compensated by cuts across other spending categories under the new IMF SBA during the second half of the year. The end result was a variation below 2%. Following the presidential elections the new administration revised the budget approved by the former government in March, mainly hiking pensions and wages. But in the context of the IMF supported program initiated in July 2010, and underperforming revenues (mainly due to overly optimistic forecasts at the beginning of the year), expenditures were revised down across categories.

#### Comparison of 2010 and 2005

3.4 According to PEFA 2006, the deviation was 0.4% in 2003, 10% in 2004, and -6% in 2005, implying B rating. Thus, there is no change between 2005 and 2010. However there were important differences in the reasons driving the variances. In the context of the 2006 PEFA assessment, most of the variation on aggregate spending was driven by mid-year revisions, typically hiking pensions and wages in the context of higher revenues. Under this assessment, while mid-year revisions took place, most of the variations and adjustments to overall expenditures in 2008-10 were driven by the shocks to the economy and their negative effect on public finances; a depreciation of the currency (more than 40% between 2008 and 2009), output drop, negative terms of trade and other shocks. Moreover, they also took place in the context of IMF programs with significant (and appropriate) focus on containing

fiscal deficits. Finally, the evaluation period also coincided with a period of political infighting (2008-9) and a change in government (2010).

### Developments in 2011

3.5 The 2011 budget was planned and approved in the context of more stable macroeconomic and political circumstances and are expected to suffer less from variations than in previous years. Yet, higher import gas prices, and lack of pension and tariff reform up to June 2011, may require additional realignments on the expenditure side.

### PI-2. Composition of Expenditure out-turn Compared to Original Approved Budget

Indicator PI-2	Dimensions to be assessed	2010 Assessment	2010 Overall	2005 Assessment*
Composition of expenditure out-turn compared to original approved budget	(i) Variance in expenditure composition during last three years excluding contingency items	D	D+	B
	(ii) Average amount of expenditure charged to contingency	A		

\*Note: Change in indicator assessment methodology since 2005.

### 2010 Assessment

3.6 **The shocks to the economy in 2008-9 and the change in administration in 2010 had serious implications for changes in expenditure composition.** The average annual variations across categories were 6.3% in 2008, 16.5% in 2009, and 16.7% in 2010. The data table supporting the scoring can be found in the Table 5.2, Annex 5. The functional breakdown was used to calculate the variance in budget composition. Economic breakdown numbers refer to adjusted planned figures while functional refers to original plan. From the perspective of the economic classification, capital expenditures and goods and services took most of the burden of adjustment of the fiscal correction in 2008 and 2009. From the functional perspective, public administration and housing and communal services suffered significant revisions in that period. In 2010, the pension and wage hikes established in March and then the revisions undertaken under the IMF supported program in July generated significant variations across expenditure categories. While capital expenditures and capital transfers were increased (in the economic classification), benefiting housing and communal services and economic activity, the budget for public administration was sharply reduced within the year.

3.7 **A “stabilization fund” was created in November 2008 and featured in the budget for 2009 and 2010.** While this fund was mainly created to deal with crisis specific needs such as Bank recapitalization, in its statutes it has a broad range of coverage of potential expenditures across multiple spending areas. Its average size is just below 10% of the total budget. Its financing comes from non-tax revenues that to some extent are contingent on privatization proceeds. However, in the context of each budget law its expenditures are clearly defined, its allocations become part of each spending unit’s allocation, and these allocations are approved by parliament in the context of the budget law. Because of the procedures set on the expenditure side, this fund cannot be categorized as a typical contingency fund.

### Comparison of 2010 and 2005

3.8 **The variations in expenditure composition under the current assessment are significantly higher than those evaluated in the last PEFA.** The 2005 indicator, re-rated based on new methodology, implies rating B, same rating as in the old methodology. According to PEFA 2006, compositional variances



were 5.7% in 2003, 12% in 2004, and 6.7% in 2005. Therefore, performance has deteriorated from B to D. Variations in spending categories in each of the last 3 years (particularly 2008 and 2009) can be mainly attributed to the external shocks that affected severely public finances and required expenditure adjustments. But these variations are also due in part to unrealistic expectations coming from the revenue side and political pressures on public finances, particularly in 2010.

### Developments in 2011

3.9 The trend of significant within-the-year reallocations across spending categories should subside in 2011, particularly in the context of a more stable macroeconomic environment and more realistic revenue assumptions.

### PI-3. Aggregate Revenue out-turn Compared to Original Approved Budget

Indicator PI-3	2010 Assessment	2005 Assessment
Aggregate revenue out-turn compared to original approved budget	<b>B</b>	<b>A</b>

#### 2010 Assessment

3.10 **Lower than planned revenue outturns in 2008 and 2009 are mainly explained by the shocks to the economy and output.** In 2008 and 2009 revenues were 99.9% and 85.5% of planned collections, respectively. While in 2008 revenues were depressed due to lower than expected output, they were also boosted due to higher than anticipated inflation, mainly in the form of higher energy and food prices. The data table supporting the scoring can be found in Annex 5.

3.11 **In 2010, lower than anticipated revenues were mainly driven by overly optimistic revenue mobilization forecasts.** In 2010, revenues were 94% of planned collections. The planned figures were based on optimistic macroeconomic forecasts underlying expected collections. They were also based on expectations of net VAT collections that were unrealistic even given optimistic macro forecasts including over estimation of gross VAT collections (in the context of slow demand growth in the economy) and underestimation of VAT refunds (forecast at below historical levels).

#### Comparison of 2010 and 2005

3.12 **Uncertainty in the context of the economic crisis and the difficulties this implies for accurate forecasting explain most of the problem, particularly in 2008 and 2009.** In 2010, over optimism about demand recovery may have played a role together with the need to show that spending hikes were to be covered.

### Developments in 2011

3.13 Revenue projections for 2011 were more realistic and a small over performance can be expected.

### PI-4. Stock and Monitoring of Expenditure Payment Arrears

Indicator PI-4	Dimension to be assessed	2010 Assessment		2005 Assessment	
Stock and monitoring of expenditure payment arrears	Stock of expenditure payment arrears (as percentage of actual total expenditure for the corresponding fiscal year) and any recent change in stock	<b>A</b>	<b>B+</b>	<b>A</b>	<b>B+</b>
	Availability of data for monitoring the stock of expenditure payment arrears	<b>B</b>		<b>B</b>	

#### 2010 Assessment

3.14 **Budget arrears have been at the low levels throughout 2008-2010.** Arrears at the end of the budget year as a share of total budget expenditures stood at 0.1%, 0.2% and 0.1% in 2008-2010 respectively. However, these figures do not include VAT refund arrears. Since the definition of when

VAT refund claims become overdue is unclear, this has been calculated as the difference between the stock of refund claims at the end of the year and new claims submitted during the previous two months. On this basis, the 2010 stock of budget arrears, including VAT, stands at about 1% of total expenditures although the situation was much worse in 2009 due to fiscal crisis when the arrears were at 5% of expenditures.

**3.15 The establishment of the Treasury commitment control system (see PI-16) has improved commitment management and thus reduced the risk of accumulation of payment arrears.** Information on arrears exists at line ministries which maintain an accrual accounting system. The Treasury reconciles their cash accounting with the spending units' accrual accounting. In 2006, the allotment system was changed and full monthly allotments for protected budget items are released by the Treasury. The fact that the spending units have modified accrual and the Treasury uses cash as well as uneven quality of accounting in different spending units justifies the B score.

### **Comparison of 2010 and 2005**

3.16 Since the previous assessment the Treasury has introduced an automated commitment management system together with full monthly allotments release for protected items.

## **■ B. Comprehensiveness and Transparency**

### **PI-5. Classification of the Budget**

<b>Indicator PI-5</b>	<b>2010 Assessment</b>	<b>2005 Assessment</b>
Classification of the budget	<b>A</b>	<b>A</b>

### **2010 Assessment**

3.17 **Administrative and economic classifications exist for national government following GFS 1986 standards.** Program classifications also exist covering all of central government expenditure included within the State Budget, including special and general funds of the Budget. The Extra Budgetary Funds (Pension Fund and three social insurance funds) are not covered.

### **Comparison of 2010 and 2005**

3.18 **There were some minor developments in the budget classification between 2005 and 2010.** The changes were introduced through several legal acts. They included MoF order #1024 of August 4, 2008 that brought economic classification of the Budget in line with GFS 2001 on some areas such as classification of services and streamlining capital expenditure classification. The MoF Order # 11 of January 14, 2011 amended budget classification to bring in compliance with the new Tax Code and revised Budget Code approved in 2010. The changes included moving customs duties from tax to non-tax revenues as well as bringing list of taxes in compliance with the Tax Code.

### **Developments in 2011**

3.19 **Work on moving to GFS 2001 standards is underway and is well coordinated with the accounting reform, which envisages accrual based IPSAS implementation in 2013.** The Strategy of State Statistics Development till 2012 (approved by the Government resolution #1413-p of November 5, 2008) and the Public Sector Accounting Reform Strategy for 2007-2015 (approved by the Government resolution #34 as of January 16, 2007) envisage the respective changes in public finance statistics and accounting standards.

### **PI-6. Comprehensiveness of Information Included in Budget Documentation**

<b>Indicator PI-6</b>	<b>2010 Assessment</b>	<b>2005 Assessment</b>
Comprehensiveness of information included in budget documentation	<b>A</b>	<b>A</b>

### 2010 Assessment

3.20 **The Annual Budget submission provides a comprehensive picture of the fiscal position**, the proposed budget and previous year comparative figures. Documents provided to the legislature include those listed below, according to the Article 38 of the Budget Code. Examples of such submission can be found on the Parliament web-site ([http://w1.c1.rada.gov.ua/pls/zweb\\_n/webproc4\\_1?id=&pf3511=39205](http://w1.c1.rada.gov.ua/pls/zweb_n/webproc4_1?id=&pf3511=39205)).

- macroeconomic assumptions underlying the budget,
- fiscal deficit,
- debt financing and anticipated composition,
- existing debt stock,
- financial assets,
- tax expenditures,
- summarized revenue and expenditure budget proposals, including current year estimated outturn and prior year outturn,
- statement on objectives that the ministry is planning to achieve as a result of execution of budget programs,
- justification of budget programs based on budget requests submitted by a ministry,
- estimations for intergovernmental transfers envisaged in the budget.

3.21 **There are two main areas for potential improvement.** First, there is no systematic registration of state owned enterprise (SOE) debt. Since SOE debt is legally not subject to sovereign guarantees this is not a reason to downgrade this indicator. However, the SOE sector is large and it may be used by supervising ministries as a form of off-budget spending and thereby present risks to the budget in the form of contingent liabilities. There is also an issue with SOE tax arrears that have been restructured regularly in the past. The report System of Financial Oversight and Governance of SOEs in Ukraine (World Bank, 2011) also suggests accumulation of fiscal risks as a result of poor oversight of SOEs. In 2011, legislation has been passed by Parliament, but not yet signed by the President, to write off close to UAH 20bn of tax arrears and penalties due from state owned companies in the energy sector. Second, the quality of analysis of the budget implications of new policy initiatives varies considerably in quality and could be improved.

### Comparison of 2010 and 2005

3.22 **There have been no changes since 2006.** The new 2010 Budget Code did not change requirements with respect to the comprehensiveness of budget documentation in regards to the indicator methodology. However, it added two important elements, namely, ministries' policy objectives for the upcoming year in relation to budget programs and ministerial multi-year ceilings.

#### PI-7. Extent of Unreported Government Operations

Indicator PI-7	Dimension to be assessed	2010 Assessment		2005 Assessment	
Extent of unreported government operations	(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.	D	D+	D	D+
	(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.	A		A	

### 2010 Assessment

3.23 **The annual state budget covers revenue and expenditure transactions of all central government entities except for four funds – Pension Fund, Social Insurance Fund, Unemployment Fund and Temporary Disability Fund.** Expenditure of these funds accounted for 20% of GDP in 2009 and slightly less (estimated 19.7%) in 2010. Each fund provides quarterly and annual financial reports and publishes them on their websites. The Budget Code also requires submission of draft Budgets of these state funds to the Parliament together with the draft annual budget (Article 38). All of the state social insurance funds are serviced by the Treasury.

3.24 **The most significant off-budget expenditures relate to quasi-fiscal activities undertaken by the State Owned Enterprises.** According to the 2010 Public Finance Assessment carried by SIGMA “the reflection in the budget of the quasi fiscal operations of state owned enterprises and the finances of such enterprises in which Government has a controlling interest is not clear”. Energy companies in particular are posing considerable risks to the budget. For example, Naftogaz’s deficit in 2009 constituted 2.5% of GDP, equivalent to around 10% of the state budget. The Naftogaz deficit target is currently part of the IMF program. The size of the quasi-fiscal activities of SOE sector leads to a D scoring of an indicator.

3.25 **Income/expenditure information for all loan financed activities is reported by the implementing units to the implementing ministry’s accounting department** and then included into the monthly financial execution reports of the Ministry of Finance. In-kind assistance is not part of the government’s fiscal reporting. Grants are also part of the reporting system. Reporting for grant and loan financing is different only as far as reporting templates are concerned.

### Comparison of 2010 and 2005

3.26 **No significant changes were made between 2005 and 2010.**

### Developments in 2011

3.27 **From 2011, under the new Budget Code, the three social funds are no longer required to present budgets to Parliament.** Board members of the funds successfully argued that, as self governing bodies, they should not be subject to Parliamentary oversight.

## PI-8. Transparency of Inter-Governmental Fiscal Relations

Indicator PI-8	Dimension to be assessed	2010 Assessment		2005 Assessment	
Transparency of inter-governmental fiscal relations	Transparency and objectivity in the horizontal allocation among SN governments	A	A	B	B+
	Timeliness of reliable information to SN governments on their allocations	B		B	
	Extent of consolidation of fiscal data for general government according to sectoral categories	A		A	

### 2010 Assessment

3.28 **Ukraine has a four tier government structure** in which one level of government supervises the next level down. Thus the State government stands above the Crimean Autonomous Republic, the oblasts and the City of Kyiv, the oblasts stand above the rayons (and cities subordinated to them), and the rayons have subordinated municipalities and villages. While oblasts and rayons have local bodies of central government, the municipalities and villages have only self-governing bodies. However, the administrative hierarchical logic does not apply to the fiscal transfer system, in that rayon level authorities receive their share of fiscal transfers direct from MoF, rather than through the oblasts.

3.29 **The arrangements for financing sub-national governments are set out in the Budget Code Law, which was reformulated in 2010.** The Tax Code specifies that all tax and non-tax revenue is collected by the State Tax Administration and State Customs Service which are under the authority of the Minister of Finance. Each unit of government receives a share of tax revenues collected within its boundaries, the shares differing depending on the tax and the level of government. The amounts of fiscal transfers are determined by a formula intended to ensure a comparable level of public services throughout the country. This takes into account projected tax and other revenues (some of which are disregarded for this purpose), and factors governing required expenditure, including population numbers, numbers of consumers of relevant services, and own-source revenue potential, thereby arriving at a situation in which each local government should have the same capacity to meet its expenditure responsibilities. The allocation formula has existed since 2001 (Resolution No.1195 of 5 September 2001) and was revised by Resolution N.1149 of 8 December 2010 to incorporate additional features.

3.30 **Article 97 of the Budget Code lists the different types of fiscal transfers:** equalisation grants, additional grants for equalisation, subventions for the execution of government programmes, compensation for revenue losses resulting from tax exemptions granted by the central government, investment subsidies, and other grants.

3.31 **The bulk of the allocation of resources to local governments (shared tax revenues and transfers from the central government taken together) is determined by transparent rules.** Article 94 of the Budget Code sets out the principles to be followed in establishing the formula while the rules relating to the equalisation transfers are set out in Resolution N.1149 of December 2010 which, as discussed above, includes the fiscal transfer allocation formula. The breakdown of fiscal transfers between rules-based (i.e. determined by clear and transparent criteria) and other is summarised in tabular form below. It is noted that these figures are national averages, which means that the actual composition of available resources may vary across local governments.

**Table 6. Inter-governmental Transfers Decomposition in Ukraine**

	2008	2009	2010
Rules-based fiscal transfers	83.3%	90.9%	92.2%
Other fiscal transfers	16.7%	9.1%	7.8%

*Source: State Treasury of Ukraine Budget Execution Reports.*

3.32 **Rules-based fiscal transfers are made up of shared revenue and special purpose grants.** Shared revenue that accrues to local government from nationally imposed taxes (mainly personal income) accounts for roughly for half of local government income, with the formula-based equalization fiscal transfer mechanism and social schemes (additional grants for equalisation) making up approximately 30 and 10 percent respectively of local government income. The remaining fiscal transfers include specific purpose grants providing for the costs of particular investment projects, and transfers providing compensation for revenue losses resulting from central government decisions. These are not governed by clear rules.

3.33 **Centrally determined allocations (i.e. revenue shares plus fiscal transfers) make up on average more than 95 percent of local government income.** With the exception of the single tax paid by small entrepreneurs, sub-national governments in Ukraine have no discretion to impose their own taxes or to vary the rates of nationally-determined taxes. Revenue accruing as a result of the decisions of individual local governments thus represents only a very small fraction of their total budgets. This leaves local governments with very little discretion over the level and pattern of their expenditure since expenditures are largely determined by the need to maintain the existing configuration of service-delivery facilities and employees, whose numbers – norms and minimum standards – and remuneration are determined centrally. Thus a system predominantly determined by

centrally mandated norms and standards effectively prevents the achievement of efficiency savings which could free up resources for investments or service improvements.

**3.34 The share of “other fiscal transfers” has decreased since 2009 and over 90 percent of transfers were rule-based in 2009-2010.** At the same time, it should be noted that increasing share of rule-based transfers could be attributed to contraction of capital spending as a result the fiscal and economic crisis.

**3.35 Projections of the tax and other revenues accruing to each local government unit are made centrally and communicated by MoF circular in June** to start the budgeting process. These projections are then taken into account in the operation of the allocation formula, and the resulting budgetary ceilings are transmitted to local governments in August providing adequate time for budget preparation. Transfers that are outside the formula are the subject of consultations between MoF and each local government unit in the course of the annual budget preparation. According to the Budget Code, budget proposals (both central and local government) are consolidated into the draft Budget Law and submitted to the national legislature (Rada) on the 15<sup>th</sup> of September. Final allocations are notified within a week of the passage of the budget by the Rada, which should take place by 1 December before the start of the new fiscal year. The annual budget law sets out the allocations to each local government in Annexes 6 and 7.

**3.36 The budget process normally ensures timely and reliable information to local governments.** Actual allocations are only known after the parliament passes the state budget which should have been by December 1 according to the Budget Code of 2001 which was effective in 2010. However, sub-national governments receive information on proposed allocation earlier before completion of their own budget deliberations. In 2010 however, the state budget 2011 was approved only on December 28 which delayed availability of information for local governments by almost a month compared to the established timetable.

**3.37 Revenues and expenditures of all government units at all levels pass through the Treasury system, and are reported in accordance with the same GFS/COFOG classification,** so providing for full consolidation of all general government expenditure on a sectoral basis.

### *Comparison of 2010 and 2005*

**3.38 Although the new (December 2010) formula has been used to determine the 2011 budget allocations, it does not appear that there have been any fundamental changes in the way resources are allocated to local governments since 2005.** The improvement in the rating is caused by the increased share of rule-based transfers associated with drop in investment transfers which are discretionary.

### *Developments in 2011*

**3.39 The main development in 2011 has been a revision of the fiscal transfer allocation formula.**

## **PI-9. Oversight of Aggregate Fiscal Risks from Other Public Sector Entities**

Indicator PI-9	Dimension to be assessed	2010 Assessment		2005 Assessment	
Oversight of aggregate fiscal risks from other public sector entities	Extent of central government monitoring of AGAs and PEs	D		D	
	Extent of central government monitoring of subnational governments' fiscal position	A	D+	A	D+

### *2010 Assessment*

**3.40 SOE oversight is weak and fragmented.** In accordance with paragraph 2, Article 141 of the Commercial Code of Ukraine (CCU), all state-owned entities are governed by the Cabinet of



Ministers of Ukraine (CoM) which in turn may delegate its powers and functions to central or local government bodies (within the executive branch). Article 5 of the Law of Ukraine “*On Management of State Assets*” defines a broad range of CoM responsibilities in governing the SOE sector, including policy development, drafting of legislation, selection of governing bodies and delegation (to them) of the functions in SOE management, monitoring and evaluation, as well as oversight. The CoM delegates its functions of SOE oversight to the line ministries and agencies as governing bodies (ownership entities) for those enterprises not deemed to be of high national interest or of national security. The MoF does not perform an active or have a direct oversight function. While the MoF monitors the implementation of financial plans, it does not evaluate individual SOEs with regard to performance nor does it review the finances of SOEs. The MoF does not approve the SOE debt unless it has sovereign guarantees or maturity longer than a year. The MoF also approved the external borrowing of SOEs.

3.41 **SOE oversight has two primary components - (i) performance indicators and (ii) ex-post inspection by KRU** – and efforts are being made to strengthen the internal audit function of government. While SOEs supposed to have in place internal audit units, the government’s internal audit service (KRU) in effect fills this role. Cabinet of Ministers Decree No. 955/ 08 (August 2001) defines the general scope of work and provides the basic procedures for planning KRU inspections and revision activities. In January 2006, amendments to the state auditing law granted authority to KRU to undertake financial and performance audits of SOEs. In May 2009 the CoM assigned KRU with a new mission – to monitor the financial transactions of the 42 largest and strategically important SOEs (CoM Resolution #506 of May 2009). This new role expected that KRU auditors were to review risky and complex/large financial transactions. This initiative was intended to assist government activities to promote more effective preventative services and better practices to uncover illicit or illegal practices. The Accounting Chamber does not audit SOEs as its oversight role is limited to reviewing the utilization of budgetary resources.

3.42 **Sub-national governments operate through the Treasury and cannot expend more than their budget.** Thus, the local budgets are part of the regular Treasury reporting. Only municipalities of certain size (over 500,000 inhabitants) can issue debt but Budget Code sets clear thresholds on the level of debt and debt service, and Ministry of Finance has to approve all debt issuance by sub-national governments. Annual financial reports are consolidated national and sub-national reports.

### **Comparison of 2010 and 2005**

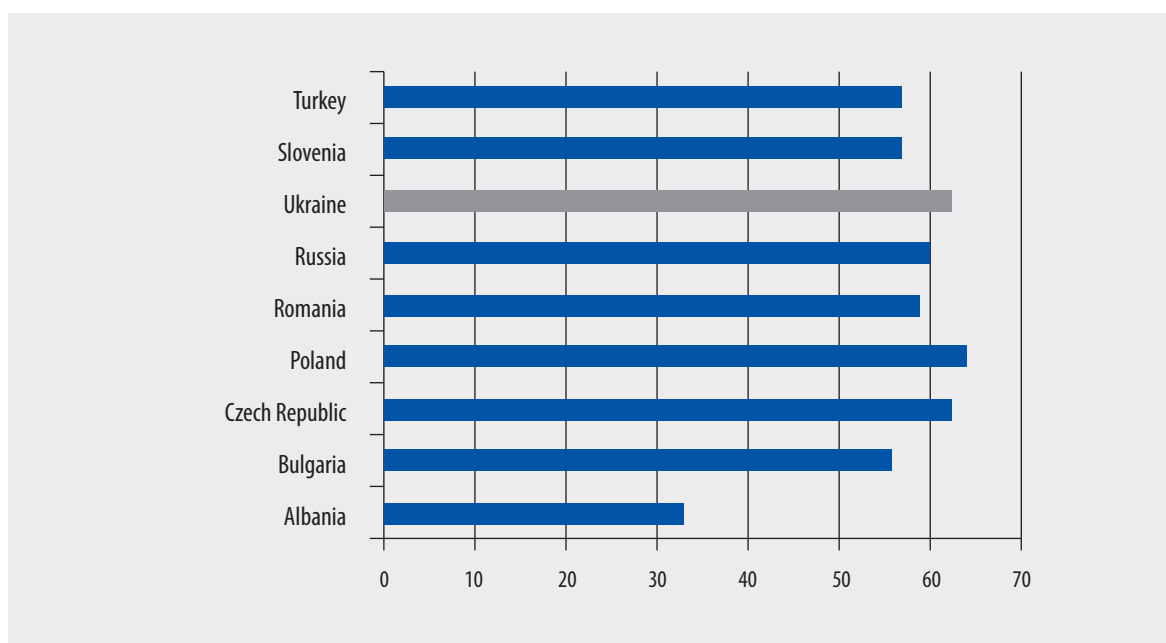
3.43 **No significant changes were made between 2005 and 2010.**

#### **PI-10. Public Access to Key Fiscal Information**

<b>Indicator PI-10</b>	<b>2010 Assessment</b>	<b>2005 Assessment</b>
Public access to key fiscal information	<b>B</b>	<b>B</b>

#### **2010 Assessment**

3.44 **Ukraine makes significant amounts of fiscal information available to the public** and scored highly (19<sup>th</sup> out of 94 countries rated) in the 2010 Open Budget Index. It also scores well in comparison to other countries in the region that are rated by OBI.

**Figure 4. Open Budget Index 2010: Ukraine and Selected Comparator Countries**

*Source: Open Budget Index 2010.*

**3.45 The PEFA scoring is based on the availability of different types of information, in particular:**

- (i) Annual budget documentation: A complete set of documents is available to the public on the Parliament's web-site ([www.rada.gov.ua](http://www.rada.gov.ua)) when the budget law is submitted to Parliament by the Cabinet of Ministers. The contents of the published submission is described in the indicator PI-6, each annex is published as a separate document to ease access to information of interest.
- (ii) In-year budget execution report. The monthly and quarterly reports are prepared by the Treasury within days of period end and submitted to the Ministry of Finance which then publishes the reports ([www.minfin.gov.ua](http://www.minfin.gov.ua), [www.treasury.gov.ua](http://www.treasury.gov.ua)). This is regulated by the Budget Code of Ukraine, Article 28 which requires the publication of quarterly and annual budget reports as well as budget execution indicators on a monthly basis.
- (iii) Yearend reports: the yearend financial statements are made available to the public by April 1 of the following year, prior to audit by the Accounting Chamber (Supreme Audit Institution). ([www.minfin.gov.ua](http://www.minfin.gov.ua))
- (iv) External audit reports. An annual summary of audit findings is posted on the Accounting Chamber web-site (<http://www.ac-rada.gov.ua>) while full audit findings are presented to the Parliament.
- (v) Contract awards: contract awards are published on the web and in the Public Procurement Herald ([www.tender.me.gov.ua](http://www.tender.me.gov.ua)) within 7 days after contract award as required by the Article 10 of the Public Procurement Law #2289-VI. The State Treasury of Ukraine checks availability of publication prior to registering commitment.
- (vi) Resources available to primary service units: Resources available to the service units are known since State Treasury services all budget users through Single Treasury Account. The information is used for expenditure control. However, it is not actively monitored by the MoF or publicly released.



3.46 **Four out of the six elements that PEFA measures are available** (external audit reports are not published in full and resources available to primary service units are not public), which results in a score of 'B'.

### Comparison of 2010 and 2005

3.47 **An important development is that** the publication of contract awards is back on track. This follows the abolition of the flawed public procurement legislative framework and its replacement by a new Public Procurement Law in June 2010. This has been recognized as acceptable by both the EU and the World Bank. Although the overall PEFA score has not changed, the Open Budget Index recorded an improvement in Ukraine's score from 55 to 62 between 2008 and 2010 on a broader set of indicators. The OBI indicators (on budget estimates, budget execution and audit) are consistent with the dimensions of transparency assessed by PEFA. An important development is that the publication of contract awards is back on track. This follows the abolition of the flawed public procurement legislative framework and its replacement by a new Public Procurement Law in June 2010. This has been recognized as acceptable by both the EU and the World Bank.

3.48 **Although the overall situation with public access to key fiscal information between 2005 and 2010 did not change from 2005, and remains in a reasonably good shape,** it is important to note that most of the publication of in year budget reports was discontinued in the second half of 2008 and 2009, during the economic crisis, when Treasury and the MoF had stopped placing execution reports on the website. Such instances indicate that practices are not self sustaining. Without the involvement of media and civil society in budget monitoring.

## ■ C. Policy Based Budgeting

### PI-11. Orderliness and Participation in the Annual Budget Process

Indicator PI-11	Dimension to be assessed	2010 Assessment		2005 Assessment	
Orderliness and participation in the annual budget process	(i) Existence of and adherence to a fixed budget calendar	B	B	B	B+
	(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent)	B		B	
	(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years)	C		A	

#### 2010 Assessment

3.49 **A clear budget calendar exists and is set out in the Budget Code of Ukraine.** The call circular is issued in June with submissions due by the end of June. Ministries have four weeks to submit their budget proposals from the time of the call circular issuance. The calendar is generally adhered to. However, in 2009 the calendar was neglected and almost all the final stages including submission to the Parliament were completed with considerable delay.

3.50 **Expenditure limits are transmitted by MoF following the approval of the call circular.** Cabinet approves economic estimates used for the budget preparation as well as the aggregate spending level prior to transmission to the Parliament. During the period under review Cabinet did not approve sector ceilings at circular stage but after the circular was issued, Ministry of Finance sent ceilings to the line ministries for them to prepare budget requests.

3.51 **Both Cabinet of Ministers and Parliament approve annual budget guidelines prior to issuance.** These set out broad policy directions to be followed in budget development as well as consolidated levels of spending, revenue and deficit. Although policy officials are involved in the budget process, it does not include approval of the sector ceilings.

3.52 **The legislature generally approves the budget before the beginning of the fiscal year.** However, the Annual budget law for 2010 was approved only in April of 2010 due to Presidential elections and political conflict within the Government. 2011 budget was approved within the prescribed timetable – on December 23, 2010. However, due to approval of the new tax and budget codes the submission to the parliament was delayed resulting in only one month for legislature review instead of three months prescribed by the legislation.

#### **Comparison of 2010 and 2005**

3.53 **No changes were made to the annual budget process during the period under review.** The adherence to the budget calendar worsened in 2009 due to short term political reasons resulting in insufficient time allocated for completion of all the required processes including legislature review in 2010. Otherwise formal adherence to the budget calendar was consistently maintained.

#### **Developments in 2011**

3.54 **The new Budget Code of 2010 introduces sector ceilings within the budget for the first time which should improve the quality of dialogue and participation by ministries.** In addition the start of the budget process has been brought forward by one month to allow increased time for Finance and Ministries to respond to the Budget Committee. In 2011 the Government seems to be on track to complete budget process according to the calendar.

The President's Economic Reform Program as well as Budget Policy Directions envisages improvements in the budgeting process.

### **PI-12. Multi-year Perspective in Fiscal Planning, Expenditure Policy and Budgeting**

<b>Indicator PI-12</b>	<b>Dimension to be assessed</b>	<b>2010 Assessment</b>		<b>2005 Assessment</b>	
Multi-year perspective in fiscal planning, expenditure policy and budgeting	Preparation of multi-year fiscal forecasts and functional allocations	<b>C</b>	<b>C+</b>	<b>C</b>	<b>C</b>
	Scope and frequency of debt sustainability analysis	<b>A</b>		<b>A</b>	
	Existence of sector strategies with multi-year costing of recurrent and investment expenditure	<b>D</b>		<b>D</b>	
	Linkages between investment budgets and forward expenditure estimates	<b>C</b>		<b>D</b>	

#### **2010 Assessment**

3.55 **Until 2010 the Government used to submit to the legislature a forecast of the main macroeconomic and fiscal indicators by main categories of expenditures, revenues and financing for the upcoming three budget periods** (Article 28 of the Budget Code of 2001) but without allocations by ministry. Historically these estimates were neglected during preparation of the following years' budgets. The new Budget Code of June 2010 (Article 21) introduced a medium term perspective into the budget process. Additionally to what was done previously, the Government is required to submit to the legislature estimates for the years t+1 and t+2 for each budget program that requires multi-year implementation (mostly investment programs). Programs for executing administrative functions of ministries would not be multi-year.

3.56 **The debt sustainability analysis is done once a year by the National Bank of Ukraine.** The Ministry of Finance also prepares an analysis of debt servicing and repayment schedule for the next three years as part of annual budget preparation annually.

3.57 **No formal requirement exists for multi-year sector strategies.** Some sectors have multiyear strategies (e.g., Transport) but only for capital expenditure, without including recurrent spending

implications. The system of state targeted programs exists in parallel, is not linked to sectors and, although costed, has a weak linkage to the budget process.

**3.58 Capital budgeting practice is weak.** While line ministries do select capital projects/programs within their annual budget ceiling and are subject to financing availability, many of the elements of sound capital budgeting system are missing. The project selection and evaluation is weak and discretionary since they are not based on thorough economic analysis, and maintenance costs are generally not considered during the decision making process in most of the cases. Execution of the capital projects is also weak as indicated in the Public Finance Review – II. However, some major programs do have both recurrent and capital cost estimates linked to each other. The main example of this is Euro 2012, which is the single largest capital program in the budget. There is also budget program requests and “passports” that contain both expenditure buy activity and by economic classification. Although they are treated formally and linkage is not strong, the quality of the estimates has improved over the last 5 years.

### *Comparison of 2010 and 2005*

**3.59 A multi-year perspective began to be introduced from 2008, involving estimates for a 3 year period beyond the annual budget.** However, these initiatives are far from the proper Medium Term Expenditure Framework: the outer year budgets did not significantly influence planning and decision making and there was little connection between the original estimates for the second year and the next year’s budget.

**3.60 Some major capital programs now identify the future recurrent cost implications for the budget.**

### *Developments in 2011*

**3.61 The new Budget Code has introduced a multi-year perspective into the budget process that will take effect during 2011 and 2012** although it is so far unclear how binding ceilings and estimates would be and other details such as procedure for introducing changes to ceilings. Medium term budgeting should, to be meaningful, reflect annual budgets on a rolling basis, be framed within multiannual expenditure ceilings considering baseline estimates, and include both capital and recurrent expenditures. There are several issues that complicate implementation of the MTEF at present and that the Government should address in course of implementation, in particular:

- Establishing a clear link between strategic planning and budgeting will require both legislative changes to the Law on Strategic Planning and Forecasting and proper implementation and monitoring of the new Budget Code provisions;
- Strengthening capital budgeting procedures to allow more thorough and systematic project appraisal and selection. This, together with increased predictability of funding should increase project execution rates and improve value for money of public investments;
- Explaining and justifying changes in estimated ministerial budget ceilings for years t+1 and t+2.

**3.62 There are ongoing plans to improve capital budgeting by introducing an improved selection and evaluation methodology for investment projects.** The regulations were already approved establishing evaluation procedures for the projects under public private partnership (PPP) arrangements and those that require state support. Implementation of multi-year ceilings would also increase predictability of financing for carrying out investments. The Government is also drafting the legislation on public investment management, aimed at improving the processes and linking public investment programs to budget cycle.

**3.63 A new draft law on Sovereign Debt and Sovereign Guarantees, that will consolidate all the existing laws and regulations, has been prepared (with IMF technical assistance) and endorsed by the Cabinet of Ministers.**

3.64 A medium term sovereign debt management strategy covering the period 2011-13 was adopted by a Cabinet of Ministers Resolution (#170). This sets targets for debt to GDP ratio to decline from 32% of GDP in 2011 to 28% in 2013. Since February 2011 the Debt Dept. has provided monthly reports to the Minister projecting debt figures and indicators out to 2025.

## ■ D. Predictability and Control in Budget Execution

### PI-13. Transparency of Taxpayer Obligations and Liabilities

Indicator PI-13	Dimension to be assessed	2010 Assessment			2005 Assessment	
		Tax	Customs	Composite	Composite	
Transparency of taxpayer obligations and liabilities	Clarity and comprehensiveness of tax liabilities.	C	C	C+	C	C
	Taxpayer access to information on tax liabilities and administrative procedures	B	C		C	
	Existence and functioning of a tax appeals mechanism	C	C		C	

#### 2010 Assessment

3.65 The assessment is based on separate assessment of tax and customs related processes covered in the three dimensions of the indicator which then are averaged to come up with the final score of C+. When comparing scores, it should be noted that the 2005 score did not include customs dimension of the indicator. The aggregation of the the tax and customs scores is done based on shares in revenue to the State Budget which were approximately equal for the Tax and Customs services due to the fact that Customs is collecting VAT on internationally traded goods.

#### Tax

3.66 A new Tax Code was adopted in 2010 to replace numerous tax laws and to create a basis for comprehensive and coherent tax legislation. The Tax Code provides a clear legislative basis for administration of most taxes, although some parts of the Tax Code (those relating to property tax and taxation of small businesses), were being elaborated in 2011. The Tax Code came into force on January 1, 2011 and is being implemented. The adoption of this composite tax legislation has substantially limited discretionary powers of the STA, and has reduced the number of sub-legal acts and internal instructions on tax administration. Unfortunately, the Tax Code still contains number of tax privileges for sectors that might create distortion and erode the tax base. In particular, such privileges are provided to meat and milk producers; space industry; aircraft industry; publishing; bio-fuel producers; gas extraction and others. All privileges are in principle “temporary” measures, although some of them are valid till 2020.

The Tax Code simplified access to tax legislation and reduced compliance costs for taxpayers in ascertaining their tax liabilities as follows:

- a) defined clear cut rules on the time frame for audits, appeals and other processes;
- b) defined a regime for automated refund for low-risk VAT payers – this is already under implementation and gradually the scope for this regime is being expanded; however the regime still relies on pre-payment verification and audit, and the time period for repayment is still significant (at a minimum 28 days) and VAT refund arrears continue to be a problem;
- c) discretionary powers of the STA have been diminished through introduction of better defined and reasonable rights and obligations of both taxpayers and tax authorities (Articles 16, 17, 20, and 21);
- d) planned audits have been limited and based on risk criteria (Article 77) and criteria for unplanned audits have also been clearly defined to limit excessive use of audit.

At the same time, these improvement did not lead to improvement in the score as the provision of the Tax Code became effective starting January 1, 2011.

**3.67 Tax accounting is based on budget classification approved by the Ministry of Finance.** Unified taxpayers accounts have not been introduced yet and should be in place upon completion of the State Tax Service Modernization Program. Taxpayers have access to legislative acts and instructions through a web-site and receive free software to submit tax returns electronically. According to the State Tax Administration, the number of taxpayers who submit their tax returns via e-mail increased from 38,500 in 2008 to 95,200 in 2010. In addition the information about companies that are under special attention/control of the tax authorities is available on an official web-site that helps to reduce the risk of dealing with unreliable partners. The State Tax Administration also conducts regular seminars and workshops providing taxpayers with legal updates including those that are introduced for the particular sectors. In 2007 a Call Center was established which operates based on a unified informational platform, and 1,153,000 consultations were given through the Center in 2010 compare with 798,400 in 2006. The tax appeals mechanism is functioning and up to 2010 has a 3 tier structure (discussed in section 3.75 below).

### Customs

**3.68 The existing Customs Code, effective since 2004, is deficient in a number of respects, a particular drawback being that its provisions are not aligned with Ukraine's WTO commitments.** As a response to this problem, separate initiatives have been launched by the State Customs Service of Ukraine (SCSU), the Ministry of Finance, and the office of the Vice-Prime Minister to draft a revised Code. Regulations governing the majority of customs operations are elaborated in secondary legislation. The SCSU's assessment of the value of imported goods frequently ignores the requirements of the WTO Valuation Agreement, being based instead upon unpublished, variable and inconsistently applied reference lists of minimum prices, rather than the transaction value of the goods (value shown on the invoice). SCSU excessively demands additional documents, sometimes those of a commercially sensitive nature, or not available to the importer, to confirm the declared transaction value. The SCSU sometimes arbitrarily assigns the tariff heading with the highest possible duty rate to consignments of imported goods. These control measures derive principally from government pressure to raise additional revenues, although the SCSU also claims that there is a general trend towards duty avoidance and fraud by importers. Nevertheless, the methods of assessment are opaque, and difficult for importers to dispute; and there is too much room for discretionary decision-making in subsequent discussions about the levels at which the value and duty rate should finally be set.

**3.69 All customs legislation can be viewed on the Parliament website,** but only in Ukrainian. Information about customs regulations and procedures can be found on the SCSU website in Ukrainian and Russian. Customs brokers and agents are currently the best source of information for importers and exporters about customs liabilities, regulations, and procedures. The Association of Customs Brokers of Ukraine, which periodically receives training from SCSU officials to update its procedural knowledge, organises free training for its 100+ members and, for a fee, for other brokers, agents, importers and exporters. There are two software products, both approved by the SCSU, which brokers/ agents use for the customs clearance process. These products are regularly updated by the SCSU to reflect important changes in duty liability, documentary requirements, etc. Access to information from brokers, however, is usually available only after the decision to import/ export has been made, and a contract agreed; it is not freely available in advance, as the basis for the decision itself. The SCSU does not publish its methods for assessing customs value, although different methods could be found in separate normative documents.

**3.70 Importers and exporters who disagree with a customs decision can appeal to the SCSU or court for a review of that decision.** In case of tax notifications, it must do so within 10 days of its receipt. The SCSU is required by law to respond to appeals within 30 days, although its internal service requirement is to do so within 15 days. The period for responding in complex cases can be extended to 60 days, provided that an initial response is provided within the statutory 30 day period. These procedures are published and transparent. In case of customs value disputes, for businesses whose imports are not covered by a financial guarantee, the removal of disputed consignments from customs control, pending



the appeal process, requires payment in advance of the full amount of duty assessed by the SCSU, and the subsequent application for a refund should the appeal be upheld. The alternative is for the goods in question to remain throughout the appeal process in a customs warehouse, effectively duty free, but usually subject to storage costs. Traders who can afford to do so therefore often prefer to pursue disputes through the courts. This practice also reflects the overwhelming tendency for SCSU reviews to uphold the original decision, as well as the fact that many decisions are arbitrary, and based upon questionable criteria.

### **Comparison of 2010 and 2005**

**3.71 Considerable progress was made on the second dimension of the indicator related to tax.** Taxpayers' access to information was improved with the establishment of a centralized Call Center by the STS and the expansion of e-filing. In addition gradual introduction of risk based audits in tax administration, and electronic register of VAT invoices are positive steps that can decrease compliance cost over longer term.

### **Developments in 2011**

**3.72 The tax appeals mechanism is functioning and has been improved since the adoption of the Tax Code.** The number of the appeal levels was reduced from 3 to 2, and time for appeals is clearly defined and limited to 140 days in total for all levels, compared with 210 days in 2005. This has removed the earlier conflict of interest situation where the first level of appeal was decided by the same tax inspectorate that imposed the adjustment or penalty. Under the new provisions, a taxpayer should appeal to the higher level (region) and thus eliminated conflict of interest. The time for appeal has been reduced from 210 days to 150 days and tax obligations become due after the appeal process is finalized. The simplified taxation and property tax parts of the Tax Code were approved in November 2011.

**3.73 A new draft Customs Code was submitted to Parliament on 12 May 2011.** The new Customs Code is more comprehensive than the current version, and incorporates provisions that (a) reflect the principles of the Revised Kyoto Convention<sup>5</sup>, to which Ukraine is a signatory, (b) align it with the EU's Modernised Customs Code, and (c) introduce the concept of electronic customs processing. Contributions to the consolidated draft have been provided by representatives of the Ukrainian business community, including the Association of Customs Brokers of Ukraine. As a result of attempts to ensure that all aspects of customs responsibilities are fully covered, the new draft Customs Code has grown to over 700 pages, which is over-long for a piece of primary customs legislation<sup>6</sup>. Its length and complexity, unless addressed, is likely to be an obstacle to ease of reference and understanding by importers, exporters, and their representatives.

## **PI-14. Effectiveness of Measures for Taxpayer Registration and Tax Assessment**

<b>Indicator PI-14</b>	<b>Dimension to be assessed</b>	<b>2010 Assessment</b>		<b>2005 Assessment</b>	
SEffectiveness of measures for taxpayer registration and tax assessment	Controls in the taxpayer registration system.	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>
	Effectiveness of penalties for non-compliance with registration and declaration obligations	<b>C</b>		<b>C</b>	
	Planning and monitoring of tax audit and fraud investigation programs	<b>C</b>		<b>C</b>	

### **2010 Assessment**

#### **Tax Service**

**3.74 There is a unified business register for all taxes.** VAT registration has been in place since 1997, and since 2005 is mandatory for businesses with annual sales over UAH 300,000. Voluntary registration was not regulated earlier. However the Tax Code has laid down rules for voluntary registration to

<sup>5</sup> International Convention on the Simplification and Harmonization of Customs Procedures.

<sup>6</sup> The existing EU Community Customs Code, for instance, is only 88 pages in length.

prevent abuse of the system for refund fraud by fly-by-night operators. Only businesses that have at least 50% of their transactions with VAT registered taxpayers can voluntarily register for VAT. Also, unlike before, the STA now has the power to deregister firms if there is no activity for 12 months. Despite the new provisions, it is too early to assess whether any significant improvement has taken place in controlling taxpayer registration and in reducing fraudulent actions by fictitious firms. Moreover, the role of detecting non-reporting or under-reporting firms is still largely with the tax militia and not a routine tax administration function. Penalties for non-compliance exist however not very effective since a number of legislative features encourage appeals, delays and court proceedings. The new Tax Code has introduced changes to the system but the effect of implementation remains to be seen.

**3.75 Risk based audit selection has been implemented since 2009 and all planned audits are now selected using risk criteria.** Risk factors are determined based on analysis of macro indicators, market intelligence and third party information. However in 2010 almost two thirds of all audits were unplanned which undermines usefulness of the risk based audit selection. Investigation of tax evasion is dealt with by the tax militia based on intelligence and third party information.

**3.76 Although many initiatives were taken to improve the system, the implementation would be the key to success.** As of 2010, the administrative burden for paying taxes is high according to international standards.

**Table 7. Administration Burden for Tax Payment**

	Payments (# per year)	Time (Hours per year)	Total tax rate (% of profit)
Ukraine	135	657	55.5
ECA	42	314	41.2
LMI Countries	35	359	40.3
World Average	30	282	47.8

*Source: Doing Business 2010.*

### Customs Service

**3.77 Ukrainian importers and exporters are registered by the SCSU at the office closest to their principal place of business.** The registration process requires the importer/ exporter to visit the customs office, and to present a range of documents and data, including the business's tax registration number, used principally to confirm its official existence. All of these details are recorded electronically, and transmitted to the SCSU main database in Kyiv, which automatically allocates a separate and unique customs registration number. Customs records of all registered importers/ exporters can be accessed using either the tax or customs registration numbers.

**3.78 Inflexible procedures restrict opportunities for consolidation (groupage) of import consignments and therefore have a negative impact on trade facilitation.** Because importers, and their customs brokers/ agents, are assigned to a specific customs house, a special application must be made to the customs office for customs clearance at another location. An authorisation can be obtained, usually within 10 days, to clear at another customs office. The registration process is usefully supplemented by the legislative requirement that importers notify their intention to import a given consignment by means of an advance summary declaration. This is logged on the SCSU database, and can be used as the basis for tracking and appraisal of the eventual importation.

**3.79 It is effectively impossible to operate as an importer/ exporter without first registering with customs.** The question of penalties for non-registration does not therefore arise. Customs declarations containing errors, deliberate or otherwise, attract enforcement action involving (a) a demand for the payment of any under-declared duties and import VAT, and (b) a financial penalty of between 25% and 100% of that additional sum, depending upon the seriousness of the transgression. Payment is required within 10 days of the importer/ exporter's receipt of the demand, unless an appeal is submitted.

3.80 **The tariff of financial penalties is set sufficiently high to act as a deterrent.** However, the frequently suspect grounds upon which duty liabilities are assessed undermine the penalties applied, by virtue of the fact that these are calculated as a percentage of the assessment. There is a high risk that importers, knowing that these will be disputed by customs officials, will set declared import values as low as possible in order to establish bargaining room in the subsequent assessment process.

3.81 **The majority of customs fiscal controls are exercised in respect of import consignments, whilst the goods are still under customs control, either at the frontier or inland.** The principal focus of these controls is an assessment of the declared value of the goods, with attention also being paid to the tariff classification. In both cases, control policy is driven by government pressure on the SCSU to raise additional customs duties, in order to meet short-term revenue targets. As a result, the SCSU largely ignores the requirements of the WTO Valuation Agreement<sup>7</sup> which requires that, in the majority of cases, the transaction value (essentially the invoice value) of imported goods be taken as the basis for calculating customs duties; instead, it assesses value according to various unpublished reference price lists, average values, and records of previous importations, using different methods at different customs offices. Invariably, the SCSU assessment of value is higher than that declared by the importer. In a similar vein, the SCSU is increasingly re-classifying imported goods at higher tariff rates than those declared. Organisations such as the Association of Customs Brokers of Ukraine, and the European Business Association, report that importers are unhappy with this control policy.

3.82 **The SCSU carries out post-clearance controls of importations on a significant scale, at the current average rate of 1,000 to 1,200 individual inspections per annum.** These inspections, carried out at importers' business premises, are a mixture of planned and *ad hoc* controls, organised independently of audits arranged by the Tax Service. Additional revenues raised by these inspections in 2010 amounted to UAH 184 million. The selection of a given import consignment for post-clearance inspection is based on analysis of the customs database, with the focus being largely upon identifying cases which are likely to yield extra revenue as a result of errors in valuation and classification, rather than being driven by risk assessment.

### **Comparison of 2010 and 2005**

3.83 **In terms of tax administration developments there is progress on tax audits in terms of implementation** of the risk-based audit selection system for planned audits in place. The share of audited companies in total is going down considerably (from 24 to 16%) although remaining considerably higher good international practice.

3.84 **A difference between 2010 and 2005 is the inclusion of a section on the customs service,** which was not included in 2005 assessment (2006 Report).

### **Developments in 2011**

3.85 **The new Tax Code became effective in 2011 and introduced some improvements have in the provisions relating to penalties.** There is a new approach to penalties which, in many cases such as non-filing, delayed filing, non-payment, delayed payment, under-reporting of income/sales, etc.), will now increase as the frequency of violation increases (first default, second default, etc.). The provisions are new and practical application will have to wait until new cases of violation are booked.

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<sup>7</sup> Article VII of the General Agreement on Tariffs and Trade (GATT) 1994.



### PI-15. Effectiveness in Collection of Tax Payments

Indicator PI-15	Dimension to be assessed	2010 Assessment		2005 Assessment	
Effectiveness in collection of tax payments	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)	B	B+	D	D+
	Effectiveness of transfer of tax collections to the Treasury by the revenue administration	A		A	
	Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	B		D	

#### 2010 Assessment

3.86 **The collection ratio for gross tax arrears was 83% in 2009 and 73% in 2010 which averages to 78%.** The overall tax arrears as a share of tax revenues stood at 5.5% average over the same two years. This is a very substantial improvement from 2006 when the equivalent figure was 18% which is equivalent with 73% collection rate for 2010.

3.87 **All tax and customs payments are paid to the account of the respective agency in the State Treasury and thus transfer is immediate.** Information on payment is then submitted to the State Tax Administration by the Treasury.

3.88 **The STA reconciles revenue data with the Treasury of Ukraine** according to the Ministry of Finance Order #317 of March 28, 2006. Reconciliation happens on the 1<sup>st</sup> day of the month following the reporting one. The treasury accounts for revenues on a cash basis and thus does not capture tax assessments, which are captured promptly (within 10 days) by the STA accounting system. The STA Order #276 of July 18, 2005 carries an Instruction on Accounting for Tax Assessment and Tax Payments by the STS. The Instruction sets forms to be used and procedures for reconciliation. According to this instruction, the full reconciliation should happen within 10 days after receiving the register of payments from the Treasury. Such reconciliation is done at the regional level and then consolidated in the center. On a monthly basis, not later than on the 4<sup>th</sup> day of the following month, the STA conducts full reconciliation of the taxes by codes of budget classification based on the data from taxpayer accounts (each taxpayer has separate account for each tax since there is no unified account). This is done according to the joint order of the STS and Treasury 436/6724 of May 20, 2005 and subsequent amendments.

#### Comparison of 2010 and 2005

3.89 **The major systems improvement since the previous PEFA report is better information sharing between the Customs and State Tax services and the State Treasury Service.**

3.90 **The improvement in tax collection performance rates can be partly attributed to aggressive collection of tax arrears in 2009 in response to the fiscal crisis and arrears restructuring conducted for SOEs (i.e., Naftogaz).** Since 2009 performance has declined but remains higher than during previous assessment.

#### Developments in 2011

3.91 **Tax arrears of the energy companies, most notably Naftogaz, may be restructured according to the legislation and the restructuring does take place according to the Accounting Chamber annual reports.** However, the law 3220 passed by Parliament writes off the entire tax debt of Naftogaz as of January 1, 2011. This would justify downgrading score to C or below on the first sub-dimension if the assessment was based on 2011 performance. While there are no expected changes in the second and third dimension of the indicator, tax arrears need to be kept under control and

restructuring of tax arrears (that is taking place in accordance with Laws of Ukraine on Measures to Ensure Functioning of Fuel and Energy Companies) should be kept to a minimum.

### PI-16. Predictability in the Availability of Funds for Commitment of Expenditures

Indicator PI-16	Dimension to be assessed	2010 Assessment		2005 Assessment	
Predictability in the availability of funds for commitment of expenditures	Extent to which cash flows are forecast and monitored	A	C+	D	D+
	Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment	A		A	
	Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs	C		D	

#### 2010 Assessment

3.92 **Following the approval of the State Budget the Ministry of Finance approves budget apportionment by month based on the inputs from the line ministries.** Based on the revenue projections, budget apportionments, and historical treasury data, the Ministry of Finance estimates monthly limits on apportionments for expenditures and credits from the general fund of the budget for main spending units. Based on these apportionments, main spending units prepare monthly breakdown by program and economic classification, send the breakdown to the MoF.

3.93 **The Treasury forecasts the annual cash flow broken down by month.** The Treasury also provides monthly forecasts with daily cash flow estimates. The monthly forecasts should be ready on the 25<sup>th</sup> day of the month prior to the forecasted one. The Treasury updates its annual projections monthly based on actual cash flows. When the Treasury submits their forecast to the Ministry of Finance, they indicate estimated balances of the Single Treasury Account so the Debt Department of the MoF can plan their domestic debt issuance in advance. Treasury actively manages cash flow by setting dates for payment of regular expenditures, such as salaries, to match expected revenue inflows.

3.94 **MDAs know their annual budget and within one month of the approval of the budget, the Ministry of Finance provides them with the annual apportionment by month and according to program and economic classification on cash basis. Treasury controls spending to the plans and apportionments.** Full monthly cash releases are made for protected items of the state budget and weekly cash releases are made for unprotected spending items. The cash releases are based on apportionments as well as the commitments registered in the Treasury system as soon as they taken by the spending unit. The commitment module of the Treasury system ensures that all commitments are taken with the budget allocations. The MDAs can commit funds within their annual budget allocations.

3.95 **Adherence to budget allocations, according to the budget classification is effectively controlled through the automated Treasury system.** Ministries can vire funds between programs and across time periods, within their overall budget ceiling, but such changes require approval from the Ministry of Finance. Reallocations between Ministries, and budget increases beyond the approved budget appropriation, require parliamentary approval. These cases are dealt with on an ad hoc basis and mainly relate to priority programs (e.g. Euro 2012). Annual budget laws were amended 14 times on average in 2010 and 2009.

#### Comparison of 2010 and 2005

3.96 **The considerable improvement in the score for the first dimension results in part from new information about the system prior to 2006, and partly from more detailed cash flow forecasting introduced from 2009.** Although the Treasury does not automatically get information from the procurement plans of the spending units and does not have centralized payroll system, it does

undertake cash flow forecasting based on Ministry of Finance expenditure allocations and the forecasts provided by the State Tax Service, Customs Service, extra-budgetary funds and the National Bank of Ukraine (debt and interest). Historical treasury data is also a reliable tool for forecasting the patterns of future cash flow. Since the last assessment Treasury has introduced full monthly allocations for protected budget items (salaries etc.) amounting to around 80% of the expenditures. Weekly allocations are provided for other items.

**3.97 A key development helping to improve predictability of funding and improved cash management has been introduction of a commitment control system as part of the Treasury system.** This has brought more discipline, helping to ensure that spending units do not enter into commitments in excess of their budget, which would potentially create arrears, The commitment control system also provides a more reliable basis for cash flow forecasting.

### PI-17. Recording and Management of Cash Balances, Debt and Guarantees

Indicator PI-17	Dimension to be assessed	2010 Assessment		2005 Assessment	
Recording and management of cash balances, debt and guarantees	Quality of debt data recording and reporting	A	B+	A	B
	Extent of consolidation of the government's cash balances	B		B	
	Systems for contracting loans and issuance of guarantees	B		C	

#### 2010 Assessment

**3.98 The quality of cash and debt data recording and reporting arrangements is good.** Ukraine is a regular member of SDDS system of the IMF and has to comply with criteria of regular reflection of key fiscal data. The State Debt Department is an integral part of the Ministry of Finance of Ukraine and maintains the database recording all state debt and sovereign guarantees. The use of the Treasury Single Account and automated Treasury system ensures consolidated reporting of daily cash balances.

**3.99 State Treasury Service of Ukraine has a debt module that records all the debt related transactions.** The internal borrowing data is entered based on the central bank information on conducted placements, the external borrowing data comes from the agreements signed and data on funds received to the Treasury accounts. Data on IFI loans is received from IFI Division of the MoF and crosschecked with the IFIs.

**3.100 The depth and quality of the published debt information is satisfactory and includes debt service, stock and operations.** The reports are published on a monthly basis on the 25<sup>th</sup> day of the month following the reporting one. The reconciliation of the debt records takes place in real time with comprehensive reconciliation quarterly. Quarterly reconciliation is required to correct for the insignificant delays in recording IFI transactions and some guaranteed debt related transactions.

**3.101 The use of a Treasury Single Account ensures that cash balances are reported on a consolidated basis.** Only special accounts for donor funded projects are outside the scope of Treasury operations, which cover all transactions of the State, local budgets, Pension Fund and other social insurance funds. The set up of the TSA is regulated in the National Bank Law.

**3.102 Ministry of Finance approves all borrowings and guarantees. Limits exist for both state debt and state guaranteed debt. These limits are set annually by the Budget Law.** The Budget Code defines cap on local debt service as a 10% of general fund expenditures and are limited to municipalities with population of over half a million. The Budget Code includes general principles for granting state guarantees (Article 17). The annual Budget Laws specify the maximum amount of guarantees to be granted as well as list of investment programs for which the state guarantees could be granted. The Cabinet of Ministers then defines procedures for granting such guarantees.

### Comparison of 2010 and 2005

3.103 **Improved data exchange between Treasury and the Debt Department of the MoF has supported publication of more detailed quarterly reports on debt by the Treasury.** The improvement of the score for the third dimension results from re-evaluation. The overall debt and guarantee ceilings are established in the Annual Budget law. Criteria for granting guarantees exist although not fully transparent and detailed. This justifies a score of B.

### PI-18. Effectiveness of Payroll Controls

Indicator PI-18	Dimension to be assessed	2010 Assessment		2005 Assessment	
Effectiveness of Payroll Controls	Degree of integration and reconciliation between personnel records and payroll data	D	D+	D	D+
	Timeliness of changes to personnel records and the payroll	C		C	
	Internal controls of changes to personnel records and the payroll	A		A	
	Existence of payroll audits to control weaknesses and/or ghost workers	A		A	

### 2010 Assessment

3.104 **Each Ministry is responsible for maintaining its own payroll system.** In the line ministry visited payroll was a module of an integrated accounting package. Personnel records are still largely manual. Treasury acts as a banker to the line ministries, making electronic payments to employees through the centralized automated Treasury system. With personnel, payroll and payment information in many separate systems, some automated and some manual, the level of integration is low and reconciliation is difficult. Information is transferred from a line Ministry as an electronic file, accompanied by a matching paper record. Each ministry is responsible for reconciliation of personnel and payroll data.

3.105 **Previous analysis indicated that it takes up to three months to update payroll to reflect changes in personnel information to update payroll,** with the result that there are frequent retrospective adjustments to the payroll. However, the decentralized nature of payroll management means there could be considerable variations in performance across ministries and it was not possible to assess performance across the whole of government in this aspect.

3.106 **Ministries have clear detailed rules and procedures governing changes to personnel and payroll information, supported by authorizing signatories and an audit trail.**

3.107 **Payroll is regularly audited by the SFI, as part of routine financial audits.** These are conducted on average every 18 months – as part of the comprehensive audits. This reportedly includes auditing personnel records and random payee verifications. Additionally Ministries own inspection units that may carry out compliance review of payroll transactions.

### Comparison of 2010 and 2005

3.108 **No significant changes have been made to the general system since 2006.** Earlier plans to introduce a centralized payroll, as part of a new IFMIS system were not carried through. Similarly plans for an integrated personnel management system for Government have not materialized.

### PI-19. Transparency, Competition and Complaints Mechanisms in Procurement

Indicator PI-19	Dimension to be assessed	2010 Assessment	
Transparency, competition and complaints mechanisms in procurement	Transparency, comprehensiveness and competition in the legal and regulatory framework	B	C+
	Use of competitive procurement methods	C	
	Public access to complete, reliable and timely procurement information	A	
	Existence of an independent administrative procurement complaints system	D <sup>8</sup>	

Indicator PI-19	Dimension to be assessed	2005 Assessment	
Competition, value for money and controls in procurement	Evidence on the use of open competition of award of contracts that exceed nationally established monetary threshold for small purchases	D	D+
	Extent of justification for use of less competitive procurement methods	C	
	Existence and operation of a procurement complaints mechanism	C	

#### 2010 Assessment

3.109 **The legislative framework for public procurement has undergone a number of major changes since 2006.** The first Public Procurement Law (PPL) was adopted in February 2000 and was in line with the good international practice. Major amendments introduced in 2004-2005 reversed the situation and distorted the public procurement system through privatization of core regulatory and oversight functions. The Public Procurement Law was abolished in March 2008 and replaced with a Cabinet of Ministers Resolution which was in place until June 1, 2010 when the new Public Procurement Law, drafted in consultation with the World Bank and EU was passed by the Parliament and came into effect. This Law is broadly compliant with international best practice and EU Directives, but requires further amendments which are presently being deliberated by the Parliament. The assessment below is based on the information available on the functioning of the system since June 1, 2010.

3.110 **Public procurement is regulated by the Public Procurement Law which has the precedence over all other acts in the area of public procurement.** The implementation arrangements are set by the Government resolutions while some methodological issues are regulated by the Ministry of Economy orders.

3.111 **The text of the PPL is freely accessible on the Parliament web-site as any other legislative act of Ukraine and on the web-site of the Authorized Agency (MoE).** The Cabinet of Ministers resolutions and authorized agency Orders are freely accessible on the web-site of the Authorized Agency.

3.112 **The PPL is applied by spending units which use budget funds to finance contracts (in full or in part) with a total cost above \$12,000 for goods and services and \$37,500 for civil works.** Currently the PPL provides for some exemptions, while the latest version of the amendment to the PPL includes more exemptions which may not be in line with the best international practices. The PPL provides for application of specialized laws in some specific cases; however this specialized legislation is still under development (in particular the law regulating procurement by Utility companies).

3.113 **The legal and regulatory framework for procurement in Ukraine is satisfying five out of six criteria of the sub-dimension (i) except for the criterion (iii):**

- (i) it is organized hierarchically and precedence is clearly established. PPL has the precedence, followed by the Cabinet of ministers resolutions and authorized agency Orders issued within the responsibilities of these bodies and in accordance with the provisions of the PPL;

<sup>8</sup> The independent administrative procurement complaints system does exist and was created in 2010, however it does not include representatives of civil society and private sector. The participation of the civil society should be handled with care given the history of PPL abuse in the past.



- (ii) it is freely and easily accessible to the public through the Parliament web-site (<http://portal.rada.gov.ua/rada/control/en/index>) and in printed editions, in particular in Official Journal and the newspaper of the Parliament (Vidomosty Verkhovnoyi Rady Ukrainy and Voice of Ukraine); Official Journal of Ukraine (Oficiniy Visnyk Ukrainy); Government Newspaper (Uriadoviy Courier);
- (iii) it applies to all procurements undertaken using government funds but with some exceptions. The exemptions are provided in Article 2.3 of the PPL (exemption of procurement made by Agrarian Fund, goods, works and services procured for preparation of elections and referendums) and in paragraph 4 of the final provisions of the PPL (procurement of food for the Army and Educational Institutions in 2011);
- (iv) open competitive procurement is the default method of procurement according to Article 20 of PPL;
- (v) government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints are publicly accessible. In accordance with Article 8.3 of the PPL, data on resolution of procurement complaints is published in a hard copy of the Official Procurement Bulletin (Visnyk Derzhavnyh Zakupivel) and on the web-site of the Anti-Monopoly Committee. Procurement Plans are published on the web-site of the Spending Unit. In accordance with Article 10 of the PPL the information on bidding opportunities, tender documents with amendments, minutes of the bid opening, rejection of bids, contract awards, evaluation report are published on the web-site of authorized agency which has free access upon registration; (<https://tender.me.gov.ua/EDZFrontOffice/>) and in a printed edition of the procurement official bulletin of the authorized agency, including international edition in English for tenders above certain threshold (goods > EUR 200,000; services > EUR 300,000, works > EUR 500,000);
- (vi) there is an independent administrative procurement review process for handling procurement complaints. The complaints are reviewed by the Anti-monopoly Committee and the decision can be appealed in Kiev administrative Court.

3.114 **Open competition is the default method of procurement.** However, current wording allows for direct contracting in “urgent cases”. Urgency is not defined and this provision can be misused, for example when procurement is not done in a timely manner, thereby creating an “urgent” situation allowing the procuring entity to for authorization to contract on a single source basis (in particular food for hospitals, schools, medicines for hospitals etc). The authorized agency was issuing permissions for application of direct contracting; however starting October 2011 each procuring entity is for selecting single source method and its justification. According to the information provided by the Authorized Agency (Ministry of Economy), the portion of direct contracting (in total contracts value) represented 40.7 % in 2010 and 26% in the first half of 2011. The amount of violations of the legal requirements of conducting single source procurement could not be estimated precisely. However, according to the SFI data, the audits and inspection of procurements revealed violations in single source approvals by the Ministry of Economy in the amount of UAH 1 billion between 2008 and 2010, which transforms to around 1% of overall amount under single source procurements during this period. Since improper although formally legal use of the single source method is frequent it transforms into the score C.

3.115 **The law stipulates that all information related to public procurement is publicly available.** All three elements, i.e. government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints are publicly available on the web site of the authorized agency accessible upon free registration and in a printed edition of Official Procurement Bulletin. In accordance with Article 7.4 of the PPL, the compliance with publication requirements is validated by the State Treasury before registration of obligations. The commitments are not registered and payments are not processed if the publication requirements have not been met by the spending unit. At the same time, according to the information provided by Anti-Monopoly Committee, the complaints on violation of



procedures for publication of information represent 29% of the total number of complaints in Public Procurement.

**3.116 The Anti-monopoly Committee (AMC) hosts the independent complaint body which reviews all complaints about public procurement which:**

- (i) is comprised of experienced professionals, familiar with the legal framework for procurement, however does not include members drawn from the private sector and civil society as well as government. The Antimonopoly committee (AMC) hosts the independent complaint body which reviews all complaints. The complaint resolution Board has 3 members, including the Chief of Board. All members are familiar with the legal framework for procurement, however have limited knowledge in specialized procurement and limited opportunities to seek advices from technical specialists. The Board does not have any members from private sector or civil society or other government entities.
- (ii) is not involved in any capacity in procurement transactions or in the process leading to contract award decisions. The members of complaint resolution Board are not involved into procurement transactions or award decisions.
- (iii) does not charge fees that prohibit access by concerned parties. The fee charged for filing complaint is not too big to discourage the bidders (\$625 for goods and services and \$1,875 for works procedures).
- (iv) follows processes for submission and resolution of complaints that are clearly defined and publicly available. The procedure is defined in the PPL and additionally AMC has developed the Manual on complaints resolution which is posted on the web-site and provides details for the process of complaints resolution.
- (v) exercises the authority to suspend the procurement process. The PPL prohibits contract conclusion during the period of 14 days when the complaint should be submitted. The complaints on the Bidding Document should be submitted before the deadline for bids submission. The Board has the right to suspend procurement process on its own initiative or on the request of complainant and until the decision on complaint is taken.
- (vi) issues decisions within the timeframe specified in the rules/regulations. The complaint is reviewed within 30 days from the date of submission.
- (vii) issues decisions that are binding on all parties (without precluding subsequent access to an external higher authority). The decisions made by the Board are binding on all parties without precluding access to higher authority (Kiev administrative Court).

**3.117 While the complaints mechanism satisfies the indicator criteria (ii) - (vii), the complaints system does not include representatives of the private sector and civil society.** Thus, following the PEFA methodology, it does not satisfy the first criteria and scores D. However, it is worth observing that in Ukraine the involvement of the NGOs and private sector as independent experts was misused under the previous system introduced in 2004-5. At that time several NGOs exercised undue influence over the functioning of the system, which resulted in rent-seeking schemes rather than protection of the public interest.

***Comparison of 2010 and 2005***

**3.118 The flawed public procurement system described in 2006 PEFA report has been changed and approximated to good international practice on all dimensions. The flawed system established by 2004 legislation, when several private organizations dominated public procurement, resulted in serious distortions of the system, which was abolished in March 2008. Finally, a completely new public procurement law was adopted in 2010, which is broadly in line with international standards.**

3.119 **Establishment of the independent complaint resolution body under the Anti-Monopoly Committee was one of the key developments that strengthened the procurement framework.** The D score for dimension 4 is the result of a change in the PEFA methodology between 2005 and 2010, and not a deterioration of the complaints resolution mechanism.

### Developments in 2011

3.120 **Given the considerable deterioration of the public procurement function in the period between 2004 and 2010, considerable efforts are still required to put the system back on track.** Distortions in public procurement started in 2005 and the system continued to deteriorate until recently, as evidenced by the Global Integrity Index, which showed a drop in score from over 60 (out of 100) in 2007 to about 50 in 2009. New amendments that were passed in 2011 have further improved effectiveness and functionality of the PPL by increasing accountability of procurement entities for application of non-competitive methods, introducing framework agreements and improving definition of procuring entities.

3.121 **More work is still needed to ensure a transparent, efficient and competitive public procurement process in Ukraine.** Some of the key elements needed moving forward are the following: (1) approving bylaws and regulations to make the system effective, including for utility companies and natural monopolies; (2) putting in place a monitoring framework to evaluate the performance of the system, including publicly available measurable outcomes to allow civil society to monitor the processes; (3) further approximation of the public procurement framework with EU Directives and investment in capacity building in beneficiary agencies to implement the new legislation.

### PI-20. Effectiveness of Internal Controls for Non-salary Expenditure

Indicator PI-20	Dimensions to be assessed	2010 Assessment		2005 Assessment	
Effectiveness of internal controls for non-salary expenditure	Effectiveness of expenditure commitment controls	B	C+	B	C+
	Comprehensiveness, relevance and understanding of other internal control rules/procedures	C		C	
	Degree of compliance with rules for processing and recording transactions	C		C	

### 2010 Assessment

3.122 **Ukraine has a highly centralised system for budget management and control,** in common with many countries of the former Soviet Union. Their main characteristic is the focus on inputs involving centralized controls on detailed line items and transactions in the budget. For the purpose of this assessment “internal control” includes the State Financial Inspectorate (SFI).

3.123 **The Treasury system, applied across all units of government at all levels, includes a module whereby commitments should be registered before orders are placed or contracts concluded,** and will only be accepted if they are within the budgetary provision held by the spending unit in question. Under this system commitments cannot extend beyond the current budget year, and if not already provided for would require virement authorisation or new appropriations as the case may be. Where projects extend beyond the initial year, it is understood that the Treasury keeps a separate record of prospective expenditure beyond the budget year, but there is no assurance that sufficient budgetary provision will be made available in future years to ensure that projects are completed.

3.124 **The STU maintains a manual on technical procedures in which all Treasury instructions are put into operational context.** In 2004 the Ministry of Finance issued Order 136 in which it outlined the relevant definitions of *commitment* accounting and set out the procedure for accounting for commitments. In 2006 the commitment registration and control process was supported by an automated

module integrated with the overall Treasury system which reportedly has had a considerable impact on budgetary discipline.

**3.125 It has not been possible to secure systematic evidence about the extent of compliance by spending unit with the commitment control system.** It seems unlikely however that there would be many self-evident errors in the registration of commitments. The extent to which spending units might mis-describe commitments to bring them within available budget provision, or the case in which spending units intending to spend outside their budgetary provision might prefer to avoid any prior notification of the Treasury may not be captured immediately by the commitment registration system. However, the resulting illegal liabilities should be identified and payments blocked at a later stage in the process.

**3.126 Ex post control by SFI and its branches throughout the country continues to identify numerous errors and violations.** SFI data provided in the 2010 Report show the total amount of illegal or inappropriate expenditure identified in 2010 is UAH 32.6 bn, with an impact on the budget of UAH 7.6 bn. It appears that many of the problems arose at SOEs rather than at budget spending units. The total amount of infringements of rules not involving losses of public funds was 58.2bn UAH; it is not stated how much of this involved the budget. These findings, which are corroborated by rather similar findings in “controls” undertaken by the the Accounting Chamber of Ukraine (ACU), appear to indicate that there are some failures to comply with controls other than those over commitments. At the same time at the interviews with the government officials, it was clear that a large share of the errors/violations are of a technical error and does not involve any losses incurred by the budget. Share of identified losses to the budget in the budget expenditures in 2010 is around 2 percent and thus that nature of infringements and materiality is such that C score is justified.

**3.127 SFI and ACU identified numerous errors and compliance failures, although their reports do not identify the nature of and reasons for these failures.** In some cases these failures apparently took the form of breaches of technical rules, for example by the debiting of special/development funds to meet expenditure properly charged to the general fund. This was attributed primarily to the pressures on managers to meet non-discretionary recurrent costs of protected expenditure items at the expense of discretionary investment and maintenance spending. In other cases they arose through management over-ride of the minimum requirements for supporting documentation before payments were executed. Although the actual payments are made electronically into bank accounts, there is much scope for manual intervention in the earlier stages of the process: supporting documentation is submitted on paper, and much depends on the vigilance of Treasury staff to spot deficiencies.

### **Comparison of 2010 and 2005**

**3.128 There have been improvements in some of the control systems since 2005, notably the introduction of systematic registration and control of commitments.** It is likely that if existing systems and rules operated satisfactorily this would justify higher ratings than the ones given in this PEFA 2011. The 2011 assessment is taking place at a time of perhaps greater economic and political difficulty than its predecessor. The 2009 Annual Report of ACU said that the most important obstacle the Chamber identified in its audits to the satisfactory development of public services was the failure of the Cabinet of Ministers and Ministries of Finance and Economy to provide spending units with the resources they needed.

### **Developments in 2011**

**3.129 The PIFC reform is now entering the implementation stage with internal audit standards developed and internal audit units being established in all central ministries and agencies.** The remit of SFI has recently been re-specified in Presidential Decree 499/2011 of 28 April 2011, so as to make clearer the service’s responsibilities for the development throughout the government of both internal control and internal audit. There has already been some useful piloting of the internal audit approach with the help of the Swedish National Financial Management Authority –

Economistyrningsverket (ESV of Sweden) in an EC twinning project providing recommendations to management about how services could be improved. This assistance has culminated in a draft PIFC law and accompanying Action Plan. SFI sees such work as distinct from its (ex post) “control” activities, leading to correction and punishment. There are plans to establish the internal audit function throughout the government over the next several years, with SFI serving as the Central Harmonisation Unit (CHU). This approach does not follow the standard EC recommendation of placing CHU within the Ministry of Finance. Moreover, the main focus of SFI work in the new Decree remains its ex post control activity. The need to address the development of internal control within each spending unit was recognised in Cabinet of Ministers Decree no.59/January 2011, which sets out the responsibilities of accounting officers and looks to reinforce accounting departments. However, SFI warn that a culture of managerial responsibility effectively discharged in each spending unit could not be relied on to emerge automatically if the threatening apparatus of ex post control were dismantled: they substantiate their position by referring to the experience of other former Soviet Union countries where a reduction in ex post control led to an explosion of irregularity.

### PI-21. Effectiveness of Internal Audit

Indicator PI-21	Dimensions to be assessed	2010 Assessment		2005 Assessment	
Effectiveness of internal audit	Coverage and quality of the internal audit function	D	D+	C	C+
	Frequency and distribution of reports	C		A	
	Extent of management response to internal audit findings	B		B	

#### 2010 Assessment

3.130 **Internal audit as defined by international standards (IIA or IAASB ) was not effectively operating in Ukraine in 2010.** A decentralized internal audit function was being developed based on the 2007 White Paper on Public Internal Financial Control (PIFC), but internal audit units were established only in 2011. The new Budget Code and Presidential Decrees 499 and 504/2011 have laid the foundations for the regulatory framework upon which internal audit can be built.

3.131 **A small part of State Financial Inspection’s (SFI) work (around 3%) is performance audit, which has some of the characteristics of systems monitoring.** For this reason this part of SFI’s work was reviewed as part of this assessment. However, these reports consist mainly of observations of objectives not being achieved, rather than a diagnosis of systemic weaknesses and recommendations for improvement. The bulk of the SFI’s work consists of ex-post inspections of compliance and investigations and relates to internal control (see PI-20).

3.132 **The current rating should not be seen as indicating a deterioration since 2006** but rather as a more accurate assessment of the status of internal audit in Ukraine, based on clear distinction between the nature of SFI’s work and that of an internal auditor. The 2006 assessment equated the inspection work done by the SFI with internal audit, which is not consistent with the PEFA methodology. .

3.133 **SFI report on inspection and audit activities are not transmitted to the SAI.** For this reason the rating for the second dimension cannot be higher than C. The SFI annual report provides a summary of the numerous and frequent reports submitted to the Cabinet of Ministries, the volume of funds in violation of rules and procedures, action taken to recover inappropriately spent funds, and the number of public officials subjected to disciplinary measures.

3.134 **The SFI’s powers to impose sanctions and corrections make it more effective in securing effective responses from inspected/audited bodies than the Accounting Chamber of Ukraine.** According to SFI 2010 report, out of 3,700 recommendations issued there have been 922 “management decisions”. The report does not specify the subject or purpose of these management decisions. This

reflects the role of SFI as an inspection body with power to impose sanctions and corrections. Its reports do not generally allow managements any discretion or independent responsibility in responding to them.

### Comparison of 2010 and 2005

The assessment did not find any deterioration in the performance of SFI since 2005. Rather, the decreased score reflects that fact that the 2006 scoring was not done in strict accordance with the PEFA methodology. It treated the work of the SFI as internal audit, whereas the current assessment has clarified that the SFI performs very limited performance review and no internal audit functions as per internationally accepted definitions.

### Developments in 2011

3.135 **Work to establish an effective internal audit function intensified in 2011.** The Government established internal audit units (Resolution #1001 of September 28, 2011) in practically all the central government agencies and conducted training of the first 100 internal auditors (November-December 2011). The internal audit standards were approved by the MoF Order #1247 of October 20, 2011. The Central Harmonization Unit under the SFI developed the Code of Ethics of an internal auditor, which was approved by the Ministry of Finance in September. The SFU has also put considerable efforts for building capacity of the newly established internal audit units. The reform efforts were supported by the EU Twinning Project with Sweden, World Bank PFM Project and other donors.

## ■ E. Accounting, Recording and Reporting

### PI-22. Timeliness and Regularity of Account Reconciliation

Indicator PI-22	Dimension to be assessed	2010 Assessment		2005 Assessment	
Timeliness and Regularity of Account Reconciliation	Regularity of bank and account reconciliations	A	A	A	A
	Regularity of reconciliations and clearance of suspense accounts and advances.	A		A	

#### 2010 Assessment

3.136 **The State Treasury of Ukraine (STU) is responsible for managing the Treasury Single Account (TSA) as well as any other government bank accounts** (which can be opened in the Central Bank or commercial banks but must be registered with the Treasury). For central government, nearly all expenditure and revenue transactions are executed via the STA and the Treasury performs daily reconciliations of flows and balances. MoF Order #263 defines the periodicity, frequency and content of managerial reports – there is daily reporting of accounts along budget classification classes 1-4; monthly and quarterly reporting of accounts along budget classification classes 1-9 as well as off-budget sheet accounts. STU Order #39 requires the reporting on budget classification classes 1-9 to be produced 15 days of the close of the month/quarter.

3.137 **Local governments typically rely on regional branches of the STU to execute their expenditure and revenue transactions.** The STU executes transfers/allocations and this is done only once authorization is granted to the local spending units. The regional treasury branches perform daily reconciliations of the local government accounts and balances are available on a daily basis as well. Therefore, since treasury executes virtually all transactions for central and local government, including decentralized spending units, the system of reconciliation generates an accurate report of payments and account balances.

3.138 **There are no suspense accounts in use in Ukraine. Advances are authorized only for specific types of contracts** (usually construction and/or large-scale infrastructure contracts) and the advances are limited to 30-40% of the total value of the contract, depending on contract terms. Once the advance payments are executed, spending units are required to demonstrate and submit documentation reporting



on the use the advance (i.e., reporting on contract execution or management and physical progress) prior to subsequent payments being executed. This reconciliation (or documentation) is required to be submitted within one month of execution of the advance payment. If this is not completed by the spending unit, the treasury withholds further payments against the contract and these contracts are noted in the monthly/quarterly reports.

### **Comparison of 2010 and 2005**

3.139 **No major changes were introduced and the system continues to function efficiently.**

### **PI-23. Availability of Information on Resources Received by Service Delivery Units**

<b>Indicator PI-23</b>	<b>2010 Assessment</b>	<b>2005 Assessment</b>
Availability of information on resources received by service delivery units	<b>B</b>	<b>B</b>

### **2010 Assessment**

3.140 **The responsibility for accounting, reporting and overall expenditure management is primarily that of the sector department within the local government administration/organization. For example, the education department within a municipal administration/organization,** through its accounting and budget unit, is responsible for all budgets, accounting and reporting functions for all schools within the municipal and rayon jurisdictions. This municipal department reports in turn to the Regional Department of Education as well as to the Regional State Administration's finance division.

3.141 **There is a clear calendar (and process) to develop budget proposals - the budgets are prepared by the sector department (e.g., education department) at the municipal level.** The initial budget ceilings are provided by the MoF and provide a framework within the detailed budget proposals are developed. The Regional Administration leads the process, with the collaboration of the municipal administrative department, to reconcile the initial budget proposals with the authorized ceilings. The municipal administrative department is responsible for informing the service delivery units of the final allocations and the detailed budget lines (by economic classification) as well as the allocations for each school/service unit.

3.142 **Local service delivery units themselves (e.g., schools, hospitals) do not operate their own bank accounts.** All revenues, including payments and other non-budgetary revenues collected through community contributions (e.g., parent fundraising) are managed and controlled by the State Treasury through its Territorial offices. Revenues and payments collected by service delivery units are credited to the State budget's Special Fund (not the General Fund) and these funds are in turn generally made available to service delivery units which had received/collected the revenue. If the collected revenues/payments are not predetermined, then the State Treasury will authorize utilization of the resources within approved budget parameters. If the revenues are deposited but have a pre-determined use (e.g., to replace school furniture), then the State Treasury records this in its records and verifies that the funds had been used for the intended purposes. The Territorial Treasury offices generate quarterly reports which are reconciled against the quarterly reports produced by the municipal departments.

3.143 **The front line service delivery units receive information on resources from departments of healthcare or education at the regional level upon approval of the local budget.** The service delivery units are considered budget holders of lower level in the budget system of Ukraine and thus receive information on their respective budgets from the main budget holders, i.e. education and healthcare departments or Ministry of Healthcare in case of specialized national hospitals.

### **Comparison of 2010 and 2005**

3.144 **Field work was able to obtain more detailed information than the previous report had been able to provide.** Based on the information that had been available in the 2006 report, there was



no noticeable or measurable difference in government policies, procedures or practices or how these policies, procedures or practices impact local service delivery units.

### PI-24. Quality and Timeliness of In-year Budget Reports

Indicator PI-24	Dimension to be assessed	2010 Assessment		2005 Assessment	
Quality and timeliness of in-year budget reports	Scope of reports in terms of coverage and compatibility with budget estimates	A	A	C	C+
	Timeliness of the issue of reports	A		A	
	Quality of information	A		B	

#### 2010 Assessment

3.145 **In year budget execution reports cover general government as a whole and are prepared according to program, functional, administrative and economic budget classifications.** They are easily compared to the approved budget. Reports covering expenditures and revenues, as well as state debt, guarantees and obligations (liabilities and payables) are prepared regularly (monthly and quarterly). Quarterly debt reports include data on conditional and guaranteed debt obligations and liabilities. Four (4) extra-budgetary funds (Pensions, Social Insurance, Interim Disability and Employment Insurance) as well as State-Owned Enterprises are not included in treasury reports on budget execution. Although this is a serious omission, it does not concern the central government budget, and thus addressed in PI-7 and does not affect score.

3.146 **The STU prepares monthly and quarterly reports of central government (revenues, expenditures, debt, liabilities/obligations and external loans) within 15 days of the end of the month and within 25 days of the end of the quarter.** Local government reports are prepared by regional treasury units and submitted to the central treasury within 8 days of the end of the month, which facilitates consolidation of data. The STU subsequently prepares monthly and quarterly consolidated reports based on functional, administrative and economic budget classifications, including the data from local governments within 25 days of the end of the month.

3.147 **The single treasury account executes all budget transactions (revenues and expenditures) for all central government ministries and central spending units.** Additionally, the regional treasury branches execute budget transactions for local governments (including oblasts) and decentralized spending units. These arrangements enable a close and regular monitoring and reconciliation (including cross-checks) of financial information and flows.

#### Comparison of 2010 and 2005

3.148 **Between 2005 and 2010 the Treasury system was expanded to cover almost all government payments, including the Pension Fund and non-payroll expenses of the defense and internal security ministries, improving both the coverage and accuracy of revenue and expenditure reporting.** The STU also implemented a commitment module in the treasury system which has enhanced the content and quality of in-year budget reporting. This has improved the ability of government to manage and account for commitments and other obligations which directly impact treasury's cash management practices. Improved procedures have reduced the time required to produce monthly and quarterly spending reports.

#### Developments in 2011

3.149 **The new Budget Code would further improve budget and financial reporting.** Changes in the 2010 Budget Code (which came into effect in 2011) clarified and simplified budget and financial reporting. Article #48 (Budget Code) defines the content of reporting on Budget Liabilities (receivables/advances and payables/current obligations). Articles #59 and #60 define the content and deadlines/process for monthly and quarterly reporting requirements respectively. MoF Order

#11 (February 14, 2011) defined new content and format of in-year budget execution reporting – including the reaffirmation of the 3 levels of reporting along functional, administrative and economic budget classifications.

### PI-25. Quality and Timeliness of Annual Financial Statements

Indicator PI-25	Dimension to be assessed	2010 Assessment		2005 Assessment	
Quality and timeliness of annual financial statements	Completeness of the financial statements	B	C+	D	D+
	Timeliness of submission of the financial statements	A		A	
	Accounting standards used	C		C	

#### 2010 Assessment

3.150 **The annual consolidated financial statements cover central and local government revenues, expenditures, government debt, financial assets, liabilities and obligations.** There are however, important omissions from these consolidated statements. Despite the fact that the inclusion of – four extra-budgetary funds (e.g., pensions, social insurance, interim disability and employment insurance) are not included required, the government’s financial statement do omit the consolidation of the state-owned enterprises where the government holds the majority and controlling share. In Ukraine, state-owned enterprises are not considered as part of general government despite the significant role they play both in terms of receiving budget allocations and transfers, and in terms of generating revenue and taxes for financing the state budget). Given the size of the pension fund (more than 10% of GDP), these omissions from the consolidated financial statements are very significant. The extra-budgetary funds utilize a separate accounting framework, produce separate financial statements and submit these to the MoF, STU, Cabinet of Ministers, Parliament and Accounting Chamber, following separate processes. At the same time the EBFs are not part of the central government budget and thus, following the PEFA methodology, their omission does not affect the score.

3.151 **The government prepares its annual financial statements within four months after the end of the fiscal year** (in accordance with Regulation #419 and Article #61 of the Budget Code). Each year, an Order of the MoF defines the specific timeline and process for the STU to follow in the preparation and submission of the annual financial statements and these requirements have been met. National accounting standards are applied in the production of the annual financial statements. National standards are mostly cash-based, with elements of accrual accounting such as reporting on assets and liabilities, debt, etc... These standards are not compliant or aligned with IPSAS, though the government is currently developing new public sector accrual accounting standards which aim to be IPSAS-accrual compliant. The national standards have been applied consistently over time and are well known within MoF and Treasury. There is limited disclosure of accounting policies/standards in the annual reports.

#### Comparison of 2010 and 2005

3.152 **The improved scoring is based on a revised interpretation of the PEFA methodology** with respect to the treatment of extra-budgetary funds. Following the advice of the PEFA Secretariat the EBFs have been excluded from the sub-indicator score on completeness of financial statements. There were no changes in government policies or practices that affected the scores.

3.153 **In 2007 the Cabinet of Ministers approved a government accounting modernization strategy** and the MoF/Treasury is currently in the processing of developing new public sector accounting standards, based on the IPSAS accrual standards. At the time of preparing this report, 12 standards had been drafted and formally approved by the MoF. An additional 12 standards are expected to be finalized and approved during 2011 with the remaining 7 standards to be developed and approved in 2012. These new standards will come into effect starting in 2013.

3.154 **Adoption of IPSAS from 2013 should bring about is the consolidation of SOE assets, liabilities and operations into the financial statements of Government.** At present, only transactions between government and SOEs (subsidiaries and dividend payments) appear in the budget and expenditure reports under the responsible line ministries. At 22-25% of GDP, SOE operations are very significant and their inclusion in government financial reports will substantially improve transparency and completeness.

## ■ F. External Scrutiny and Audit

### PI-26. Scope, Nature and Follow Up of External Audit

Indicator PI-26	Dimensions to be assessed	2010 Assessment		2005 Assessment	
Scope, nature and follow-up of external audit	Scope/nature of audit performed	D	D+	D	D+
	Timeliness of submission of audit reports to legislature	B		A	
	Evidence of follow-up on audit recommendations	B		B	

#### 2010 Assessment

3.155 **The Accounting Chamber of Ukraine (ACU) is formally subordinated to the National Parliament (Rada). Its remit is to “control” expenditure from the State Budget.** Its control activities are thus very similar to those of the State Financial Inspection – SFI (also known as *KRU*), the distinction being that SFI reports to the government, while ACU reports to the Rada. Although the 1997 law governing ACU’s work envisages cooperation with SFI, in practice this does not take place. The Head and other members of the Board of ACU are appointed by the Parliament for seven year terms. Financial provision for the work of the Chamber is set in the annual budget in the same way as for other spending units.

3.156 **The main focus of the ACU’s work continues to be on ex post compliance control of expenditure from the State Budget in accordance with the remit in the 1997 law.** The Chamber stated during interviews that its approach is to carry out “integrated” audits which cover compliance, financial and performance aspects of the activities audited. It covers all the government units within its mandate over a three year cycle, which implies that there is less than 50 per cent coverage in any one year, and non-coverage of EBFs reduces it even further.

3.157 **ACU’s remit excludes revenue, local governments, extra-budgetary funds and SOEs, except to the extent that State budget funds are concerned.** The ACU has no role in relation to SOEs or extra-budgetary funds (four extra budgetary funds represent close to 20% of GDP). Some audit areas can only be addressed with the approval of Parliament. A constitutional amendment (Law N 2222-IV on Amendments to Constitution of Ukraine of 8 December 2004) gave ACU the right to audit revenue in addition to expenditure effective from 2005. This extension of competence, however, was withdrawn by decision N.20 rp/2010 of 30 September 2010 of the Constitutional Court. ACU’s remit is thus much narrower than that of SFI. ACU does not certify government financial statements (or assets and liabilities in any form), or report on the reliability of the systems through which they are produced.

3.158 **ACU annual reports provide aggregate figures for the amounts of different types of error identified in that year’s audits** (the 2009 Report shows a sharply rising trend, with the overall totals involved increasing from 12bn UAH in 2007 to 36bn UAH in 2009), together with lists of areas audited, but do not include any analysis of the reasons for problems, or examples of action necessary to overcome them. With the assistance of the Swedish RRV, the Chamber has initiated work on auditing the performance of government programmes where objectives have been set for achievement within a given timescale.

3.159 **The ACU is required to submit a report to the Rada on the annual budget execution statement produced by the Cabinet of Ministers within two weeks of its receipt from the government** (see Articles 61 and 62 of the Budget Code). ACU apparently meets this tight deadline, but the report in question is descriptive only and based on all compliance and performance audits from the previous year. ACU’s overall Annual Report for the previous year is produced by the 1<sup>st</sup> of December of

the current year (Article 35 of the Accounting Chamber Law, 1996), but does not include any discussion of the government's financial statements. Since this overall annual report is produced within 8 months of the receipt of the budget execution statement, the rating for dimension (ii) is B. The timeline was adhered to in 2010 for the 2009 annual report. Other reports on specific audits are published throughout the year and transmitted without delay to Rada and the Cabinet of Ministers.

**3.160 Formal response to audit findings and recommendations comes primarily from the audited government bodies and the Cabinet of Ministers who should reply within 15 days from receiving a report (Article 29 of the Accounting Chamber Law).** The Rada discusses ACU reports on a case by case basis and "...upon consent of the Parliament..." as specified in Article 34 of the Accounting Chamber Law. The ACU's 2009 Annual Report states that bodies audited have in a number of cases taken the corrective measures required, and accepted the audit recommendations. A dedicated unit in ACU is responsible, among other things, for following up on actions undertaken by audited institutions in response to the Chamber's findings and recommendations. In discussion ACU officials had pointed out that the recommendations were not taken into account to a desired extent and thus did not make a significant contribution to improving the quality and efficiency of public service provision.

**3.161 Although ACU officials participate in the meetings of a number of Parliamentary Committees, it appears that the Rada in practice pays insufficient attention to ACU's work.** The Chamber also appears to receive little support from the Cabinet of Ministers or MoF. Since (apart from the power to refer issues to the Public Prosecutor) it lacks the sanctions available to SFI, its recommendations can be taken lighter by government units.

#### **Comparison of 2010 and 2005**

**3.162 There have been both positive and negative developments since 2006.** Work has been done to develop performance audit, although the ACU remains largely focused on compliance audit. The ACU's remit has been narrowed to exclude audit of government revenues, its audit coverage in any one year remains well below 50 per cent (ACU annual reports), and it undertakes no audit of the government's budget execution and other financial statements.

#### **Developments in 2011**

**3.163 There is a strong need for extended ACU mandate to ensure external audit of revenues as well as extra budgetary funds.** The draft law on ACU has been under development for several years but constitutional amendments are required to broaden SAI mandate. ACU has proposed changes to the law which have not yet been taken into consideration. Management changes are due this year as the Head of the Chamber reaches the end of his second seven year term. Meanwhile the government's interest seems to be more in the development of internal control and internal audit than external audit. Indeed, ACU's remit is much narrower than that of SFI. The limited mandate of the ACU prevents the Chamber from effectively fulfilling its mandate as guarantor of the integrity of the cycle of public accountability.

### **PI-27. Legislative Scrutiny of the Annual Budget Law**

<b>Indicator PI-27</b>	<b>Dimension to be assessed</b>	<b>2010 Assessment</b>		<b>2005 Assessment</b>	
Legislative scrutiny of the annual budget law	Scope of the legislature's scrutiny	<b>B</b>	<b>C+</b>	<b>B</b>	<b>B+</b>
	Extent to which the legislature's procedures are well-established and respected	<b>B</b>		<b>A</b>	
	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)	<b>A</b>		<b>A</b>	
	Rules for in-year amendments to the budget without ex-ante approval by the legislature	<b>C</b>		<b>A</b>	

### 2010 Assessment

3.164 **The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue.** The Budget Code set responsibilities of the Parliament and Parliament Budget Committee. Currently Budget Committee composition has to reflect the overall Parliament composition in terms of party and fraction proportions. There are 33 MPs in the Budget Committee of the Parliament. There are also 30 civil servants working in the Secretariat of the Budget Committee.

3.165 **Although procedures are generally well established they were not observed in relation to the 2010 Budget (see details in PI-11) because of political disagreements against the background of a particularly difficult economic situation.** According to the previous Budget Code that was used for budget preparation in 2008-2010, the Government submits Main Directions of Budget Policy to the Parliament and Parliament approves it with its resolution by the end of May. This provides Rada the opportunity to review the larger issues of fiscal policy prior to the budget proposal review in fall. The Rada has clear procedures for consideration of the Budget. The Budget Committee is in charge of detailed review while sectoral committees may comment upon relevant section of the budget as inputs to the Budget Committee.

3.166 **The procedure for approval of the Budget 2011 was broadly adhered to.** The 2011 Budget Law was submitted by the Cabinet of Ministers in December 10, 2010 with a delay due to approval of the new Budget Code. However, the Budget Committee reviewed it in course of December and on December 28, 2010 the Budget Law for 2011 was approved by the Parliament.

3.167 **The legislature has more than two months to review the budget proposal.** The Government has to submit the budget to the Parliament by September 15 and the Minister of Finance presents proposal by September 20. On October 20, first reading is conducted, based on which the Parliament send the Budget back to the Government with comments. By November 3, the Government has to submit revised Budget that is then again reviewed and approved in late November – December.

3.168 **The Rada's own rules of procedure set narrow limits on legislative amendments to the budget.** (These limits were formerly in the Budget Code, but the new version relies on Rada's rules.) The proposals should be balanced meaning that proposals for increasing expenditures should identify sources of financing (i.e., revenues) and the proposals to decrease revenues must identify sources how to cover losses (other revenues sources of cut in expenditures). Proposals for changes in the forecast of tax revenues are not allowed.

3.169 **The Budget Code allows for amendments to the Budget in case of revenue targets not met.** If the revenue targets deviate by 15% or more in any direction from planned based on quarterly report, Ministry of Finance initiates amendments to the annual Budget law. Article 55 provide for protected items allocation for which cannot be reduced in year. In year changes to the Budget require amending the Budget law by the Parliament except for few cases. If the changes are related to reallocation between programs but within main spending unit or the budget program is shifted from one main spending unit to another, such changes could be done by the Ministry of Finance with approval of the Parliament Budget Committee. However, MoF retains a wide discretion to cut back allocations below the approved budget, without Parliamentary oversight. Because of this wide discretion of MoF, which was not commented on in the 2006 assessment, a rating of C is proposed for the dimension (iv), resulting in an overall rating for this indicator of C+.

### Comparison of 2010 and 2005

3.170 **There were no major changes in practices between 2005 and 2010.** Slippages in performance occurred in some instances and were related to political cycle (e.g., Presidential elections affecting approval of the Budget for 2010 in 2009 however 2011 Budget was approved on schedule). The new Budget Code was approved in 2010 however it became effective since January 1, 2011 and implementation will take place during preparation of 2012 budget. The lower rating for 2011 reflects



the extent of MoF discretion to cut back allocations without reference to the legislature, as happened during post crisis years (2009).

### **Developments in 2011**

3.171 **The 2010 Budget Code has allowed more time for MoF and MSUs to prepare budget proposal following approval of the budget circular by the Rada.** The submission and approval of Main Directions of Budget Policy has shifted by one month and the Parliament has to approve the document by May 1. This will allow for more time for the Ministry of Finance to prepare the Budget and thus more time for main spending unit to submit their budget proposals. As of now, the new calendar has been adhered to (in terms of budget circular). If implemented properly, this has potential to improve first dimension score from B to A.

### **PI-28. Legislative Scrutiny of External Audit Reports**

<b>Indicator PI-28</b>	<b>Dimensions to be assessed</b>	<b>2010 Assessment</b>		<b>2005 Assessment</b>	
Legislative scrutiny of external audit reports	Timeliness of examination of audit reports by the legislature	<b>B</b>	<b>D+</b>	<b>B</b>	<b>D+</b>
	Extent of hearings on key findings	<b>D</b>		<b>D</b>	
	Issuance of recommended actions by the legislature and implementation by the executive	<b>C</b>		<b>D</b>	

### **2010 Assessment**

3.172 **The Legislative scrutiny of the of the external audit reports is weak in Ukraine.** This is also supported at the Open Budget Index 2010. The overall score of the legislative scrutiny and Supreme Audit Institution is low (49) compared to aggregate score of 62 that Ukraine has. The OBI points to particular weaknesses including absence of the publication of report by SAI or legislature tracking actions taken by executive to address audit recommendations. Thus, OBI assessment is consistent with the PEFA report findings.

3.173 **The review team was unable to obtain sufficient information about the substance and impact of ACU's work, and the attention paid to it by the Rada to enable a fully satisfactory analysis of this Performance Indicator to be made.** The analysis and scoring below is mainly based on statistical information provided by ACU about the number and proportion of its reports considered by the Rada Budget Committee.

3.174 **The Accounting Chamber of Ukraine (ACU) reports on the previous year's budget execution statement, within two weeks of its receipt** from the Cabinet of Ministers (Budget Code, Article 62). These reports, which are analytical and do not rest on audit examination, are considered by the Rada in reaching its conclusions on the execution statement (Budget Code Article 109 paragraph 2 (3)). In addition Article 110 of the Budget Code requires quarterly reports to the Rada on budget execution, and Article 33 of the 1996 ACU law requires the Rada to consider the impact of ACU controls at least twice a year. The annual and quarterly reports are reviewed by the Budget Committee prior to Parliament consideration which was done within 6 months of the submission in 2009-2010. Other audit reports on specific issues and budget programs are reviewed by the Parliament through its committees but there is no timeline established and the team was not able to obtain the information on time it takes the Parliament to process them. The score for dimension (i) is based on the annual and quarterly reports review.

3.175 **Other audit reports may be considered by the Budget Committee or referred to other parliamentary standing committees that deal with specific sectors, depending on the subject matter.** According to ACU 225 letters reporting audit results were sent to the Rada in 2009-10. During this period the Rada endorsed 64 per cent of the 2009 reports, and 47 per cent of those made in 2010, with the remainder being simply noted by the Budget Committee. ACU staff members and audited bodies



representatives were present during the Rada Committee's discussions. Follow-up is undertaken by ACU on the basis of a list of recommendations for corrective action; if recommendations are implemented in full, they are removed from the list of outstanding issues.

3.176 **The ACU's annual report states that its recommendations have been taken into consideration by the Rada and the government, but gives no specific examples of the recommendations or the action taken in response to them.**

3.177 **The follow up on recommendations made by the Rada based on ACU reports is very limited, resulting in a C rating for dimension (iii).** The focus of audit continues to be on compliance of specific transactions with applicable rules, rather than on identifying improvements in systems.

### Comparison of 2010 and 2005

3.178 **No major changes are evident since 2006 in the way the Rada deals with ACU reports.** The Rada apparently pays relatively little attention to the work of ACU, and has not acted on the draft of a new law which would strengthen the basis of ACU work. At the same time there was some progress in terms of examining the ACU reports and issuing the recommendations based on them.

## ■ G. Donor Practices

### D-1. Predictability of Direct Budget Support

Indicator D-1	Dimension to be assessed	2010 Assessment		2005 Assessment	
Predictability of direct budget support	Annual deviation of actual budget support from the forecast provided by the donor agencies at least 6 weeks prior to the government submitting its budget proposals to the legislature	D	D	NA	NA
	In-year timeliness of donor disbursements	D		NA	

### 2010 Assessment

3.179 **In 2008-2010, World Bank Development Policy Loans (DPLs) and European Union sector budget support programs were the two main sources of budget support to Ukraine<sup>9</sup>.** As demonstrated in the table below, in the three years under review budget support outturn deviated from the forecast by more than 15%. Deviations have been mainly caused by delays in fulfillment of conditions for disbursement by the Government or by exchange rate depreciation and additional budget support at the end of 2008 as a result of fiscal crisis. At the same time, donors' programming and implementation cycles do not follow the Ukrainian budget calendar, making it difficult to assure predictability in estimated disbursement of funds.

3.180 **Comprehensive and timely forecasts, annual and by quarter, are not provided by all donor agencies.** Release of the World Bank DPLs is linked to a satisfactory performance against institutional or policy actions making quarterly disbursement estimates not applicable. The European Commission is the only donor that provides both annual and quarterly disbursement schedules in its sector budget support financing agreements with the Government of Ukraine. This information is updated upon request by the Ministry of Finance during the annual budget preparation process in order to adjust multi-annual budgetary projections. However, during the period under review these quarterly forecasts were missed by more than 50% due to disbursement delays.

<sup>9</sup> The part of the IMF Stand-By Arrangement (SBA), which was provided in support of the state budget in 2009 and 2010 (UAH 36.8 billion and 15.9 billion respectively) has not been taken into account in this assessment considering that IMF Stand-By Arrangements are not eligible to be reported as Official Development Assistance (Annex 2 of the OECD DAC Statistical Reporting Directives).

**Table D-1a: Planned and Actual Budget Support 2008-2010**

	UAH '000		
	2008	2009	2010
<b>Total budget support budgeted</b>	<b>2,803,400.0</b>	<b>10,020,160.1</b>	<b>4,522,522.0</b>
<i>Budgeted grants</i>	303,400.0	662,160.1	522,522.0
<i>Budgeted program loans</i>	2,500,000.0	9,358,000.0	4,000,000.0
<b>Total budget support disbursed</b>	<b>5,698,263.6</b>	<b>3,398,670.5</b>	<b>125,468.7</b>
<i>Disbursed grants</i>	288,263.6	195,950.5	125,468.7
<i>Disbursed program loans</i>	5,410,000.0	3,202,720.0	0.0
<b>Performance</b>	<b>192.9%</b>	<b>33.9%</b>	<b>2.8%</b>

*Source:* Annual budget laws; Ministry of Finance.

### Comparison of 2010 and 2005

3.181 Indicator D-1 was not assessed in the 2006 PEFA as there had been only one budget support program running (a WB DPL) and no conclusion could be drawn based on data available at the time of the assessment.

### Developments in 2011

3.182 There have been no observable improvements in predictability of budget support in 2011. Making budget support more predictable in Ukraine remains a challenge that can only be addressed by increased attention and coordination between the government and donor agencies.

## D-2. Financial Information Provided by Donors for Budgeting and Reporting on Project and Program Aid

Indicator D-2	Dimension to be assessed	2010 Assessment		2005 Assessment	
		D	D	D	D
Financial information provided by donors for budgeting and reporting on project and program aid	Completeness and timeliness of budget estimates by donors for project support	D	D	D	D
	Frequency and coverage of reporting by donors on actual donor flows for project support	D		D	

### 2010 Assessment

3.183 According to the Ministry of Finance, most donors do not provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification.

3.184 The World Bank and the EC provide disbursement estimates. However, these estimates use donor formats, which do not follow the Government's budget classification and are not connected to the state budget calendar.

3.185 At the time of budget preparation the Department for cooperation with IFIs of the Ministry of Finance puts together its own budget estimates, which are based on (i) updated information received from donors upon request, and (ii) information contained in budget requests from spending units adjusted by historical disbursements of given projects and their *procurement plan*. The information is then submitted to the Budget Planning Department of the Ministry of Finance.

3.186 As is the case of budget estimates, most donors do not provide reports on actual financial flows for their projects and programs. The government relies on its own reporting system through the Single Treasury Account for program aid, and through implementing agencies for projects. The Ministry of Finance consolidates the information in preparing the monthly budget execution reports.

3.187 **In the case of the World Bank, the government has access to the electronic system “Client Connection”,** which provides it with regular updates of actual disbursements, including a monthly disbursement summary. The WB sends a monthly disbursement summary of disbursed loans at the beginning of each month for the previous month. These reports are presented in a format different from the government’s budget classification and are used for reconciliation between donor disbursement records and government project accounts. Since the share of World Bank projects cannot be calculated due to donors not providing reports on financial flows, the rating for dimension (ii) is D.

### **Comparison of 2010 and 2005**

3.188 No material changes have taken place since 2006. There is no comprehensive information system on international development assistance in Ukraine and information about donor flows is fragmented and sketchy.

### **Developments in 2011**

3.189 **The 2011 Budget law incorporated for the first time a list of externally financed projects for appropriation in the Special Fund as a separate annex<sup>10</sup>.**

### **D-3. Proportion of Aid that is Managed by Use of National Procedures**

<b>Indicator D-3</b>	<b>2010 Assessment</b>	<b>2005 Assessment</b>
Proportion of aid that is managed by use of national procedures	<b>C</b>	<b>D</b>

### **2010 Assessment**

3.190 **No project aid in Ukraine covers the entire range of the criteria for use of country systems** (i.e., where banking, payments, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds)<sup>11</sup>. International financial assistance to the government is included in the annual budget law and reported in budget execution reports. Execution of donor financed activities other than budget support, which by definition uses the national procedures, typically follows special arrangements outside of Ukraine’s regular PFM system. Some elements of the country systems are used in Ukraine by the World Bank to a very limited extent. All World Bank financed investment projects that became effective after July 1, 2007, are implemented using the treasury system.<sup>12</sup> While the foreign currency funds are held in commercial bank (state Eximbank) accounts opened in the name of the Treasury, these accounts are part of the Single Treasury Account and their balances are monitored and consolidated daily. Also, for one investment project (Social Assistance Systems Modernization), the Accounting Chamber of Ukraine has been carrying out annual project audits.

3.191 **The department for international technical assistance and cooperation with IFIs at the Ministry of Economy operates a database of technical assistance projects (grants) in Ukraine.** The main donors include the US Government agencies (USAID, DoE, USDA), the European Commission, Germany (GIZ), Sweden (SIDA), etc. By law, all donor projects have to be registered at the MoE. Statistics generated by the MoE database are used by the National Bank of Ukraine to calculate the balance of payments.

3.192 **As can be seen in table D-3, more than 57% of total aid funds originally pledged to central government in the period 2008-2010** would be subject to national procedures due to the predominance of budget support in the total volume of aid to Ukraine. The share of the aid using national procedures transforms in C score for the indicator

<sup>10</sup> Annex 9 of 2011 State Budget Law; Budget Code, article 21, article 40 (para 10).

<sup>11</sup> Also see 2011 Paris Declaration Survey for Ukraine.

<sup>12</sup> Resolution of the Cabinet of Ministers # 1090 dated September 5, 2007 “Some Issues Regarding Implementation of the Budget Programs for Realization of Economic and Social Development Projects supported by the International Bank for Reconstruction and Development”.

**Table D-3: Aid Managed Through National Procedures (planned)**

	UAH '000		
	Total 2008-2010	National procedures	Donor procedures
Grant budget support	1,488,082.1	1,488,082.1	
Program loans	19,716,000.0	19,716,000.0	
Investment project loans	8,918,580.3		8,918,580.3
Technical assistance projects	6,806,817.9		6,806,817.9
<b>Total</b>	36,929,480.3	21,204,082.1	15,725,398.2
<b>% of total aid funds</b>		<b>57.1%</b>	<b>42.9%</b>

*Source:* State budgets 2008-2010, Ministry of Economy.

### **Comparison of 2010 and 2005**

3.193 Notwithstanding delays in disbursement, there has been a clear trend since 2006 towards donors delivering more budget support, which increases the use of national procedures in managing aid. Adoption of Resolution N.1090 in the second half of 2007, which foresees servicing of WB financed projects using the treasury system, is an important development. Additionally, dialogue has started between the Accounting Chamber of Ukraine (ACU) and the WB in piloting auditing of the WB financed projects by the ACU. It should be noted, however, that even in the one instance of a WB project being audited by the ACU, the latter had to modify its auditing standards to cater to the WB requirements.

# ANNEXES

## Annex 1: Summary of 2005 and 2010 Assessments by Performance Indicator

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
<b>A. PFM OUT-TURNS: Credibility of the Budget</b>				
<b>PI-1</b>	Aggregate expenditure out-turn compared to original approved budget.	<b>B</b>	<b>B</b>	Actual aggregate expenditures varied from planned figures in 2008 and 2009 mainly as a consequence of the external shocks suffered by the economy. Aggregate expenditures varied by 4.6% in 2008 and 11.6% in 2009, and only 1.4% in 2010 (i.e., outturns below planned figures). The variations should be treated with care as they took place in the context of a massive depreciation of the currency (more than 40% between 2008 and 2009), output drop, negative terms of trade and other shocks.
<b>PI-2</b>	Composition of expenditure out-turn compared to original approved budget.	<b>D+</b>	<b>B</b>	
	(i) Variance in expenditure composition during last three years excluding contingency items.	<b>D</b>	-	The shocks to the economy in 2008-9 and the change in administration in 2010 had serious implications for changes in expenditure composition. The average annual variations across categories were 6.3% in 2008, 16.5% in 2009, and 16.7% in 2010.
	(ii) Average amount of expenditure charged to contingency	<b>A</b>	-	A "stabilization fund" was created in November 2008 and has been part of the budget in 2009 and 2010 to deal with crisis specific needs. Its average size was about 10% of the total budget. However, in the context of each budget law its expenditures are clearly defined, its allocations become part of each spending unit's allocation, and these allocations are approved by parliament in the context of the budget law. Because of the procedures set on the expenditure side, this fund cannot be categorized as a typical contingency fund.
<b>PI-3</b>	Aggregate revenue out-turn compared to original approved budget.	<b>B</b>	<b>A</b>	In 2008, 2009 and 2010 revenues were 99.9%, 85.5% and 94.4% of planned collections, respectively. Uncertainty in the context of the crisis and the difficulties this implies on accurate forecasting explain most of the problem, particularly in 2008 and 2009. In 2010, over optimism about demand recovery may have played a role together with the need to show that spending hikes were to be covered. Revenue projections for 2011 were more realistic and a small over performance can be expected.
<b>PI-4</b>	Stock and monitoring of expenditure payment arrears.	<b>B+</b>	<b>B+</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.	<b>A</b>	<b>A</b>	Budget payment arrears at the end of budget year as a share of total budget expenditures stood at 0.1%, 0.2% and 0.1% in 2008-2010 respectively.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(ii) Availability of data for monitoring the stock of expenditure payment arrears.	<b>B</b>	<b>B</b>	Information on arrears exists at line ministries which maintain an accrual accounting system. The Treasury reconciles their case accounting with the spending units' accrual accounting. In 2006, the allotment system was changed and full monthly allotments for protected budget items are released by the Treasury.
<b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>				
<b>PI-5</b>	Classification of the budget.	<b>A</b>	<b>A</b>	Administrative and economic classifications exist for national government following GFS 1986 standards. Program classifications also exist covering all of central government expenditure included within the State Budget including special and general fund of the Budget.
<b>PI-6</b>	Comprehensiveness of information included in budget documentation.	<b>A</b>	<b>A</b>	The Annual Budget submission to the legislature provides a comprehensive picture of the fiscal position, the proposed budget and previous year comparative figures (i.e., macroeconomic assumptions; fiscal deficit; debt financing and anticipated composition; existing debt stock; financial assets, tax expenditures; revenue and expenditure budget proposals, including current year estimated outturn and prior year outturn; statement on objectives of ministries in relation to the execution of budget programs; justification of budget programs; estimations for intergovernmental transfers.
<b>PI-7</b>	Extent of unreported government operations.	<b>D+</b>	<b>D+</b>	
	(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.	<b>D</b>	<b>D</b>	The annual state budget covers revenue and expenditure transactions of all central government entities except for four funds – Pension Fund, Social Insurance Fund, Unemployment Fund and Temporary Disability Fund. Expenditure of these funds accounted for 20% of GDP in 2009 and slightly less (estimated 19.7%) in 2010. Each fund provides quarterly and annual financial reports and publishes them on their websites. The Budget Code also requires submission of draft Budgets of these state funds to the Parliament together with the draft annual budget. All of the state social insurance funds are serviced by the Treasury. The most significant off-budget expenditures relate to quasi-fiscal activities undertaken by the SOEs.
	(ii) Income/ expenditure information on donor-funded projects which is included in fiscal reports.	<b>A</b>	<b>A</b>	Income/expenditure information for all loan financed activities is reported by the implementing units to the implementing ministry's accounting department and then included into the monthly financial execution reports of the Ministry of Finance. In-kind assistance is not part of the government's fiscal reporting. Grants are also part of the reporting system. Reporting for grant and loan financing is different only as far as reporting templates are concerned.
<b>PI-8</b>	Transparency of inter-governmental fiscal relations.	<b>B+</b>	<b>B+</b>	



	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(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</b>	<b>B</b>	Each unit of government receives a share of tax revenues collected within its boundaries, the shares differing depending on the tax and the level of government. The amounts of fiscal transfers to oblasts, rayons and cities are determined by an equalization formula. This takes into account projected tax and other revenues (some of which are disregarded for this purpose), and factors governing required expenditure, including population numbers, numbers of consumers of relevant services, and own-source revenue potential. As a result of decreased investment grants which are discretionary, the share of rule-based transfers in Ukraine exceeded 90% in both 2009 and 2010.
	(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year;	<b>B</b>	<b>B</b>	Projections of the tax and other revenues accruing to each local government unit are made centrally and communicated by MoF circular in June. These projections are then taken into account in the operation of the allocation formula, and the resulting budgetary ceilings are transmitted to local governments in August providing adequate time for budget preparation. Transfers that are outside the formula are the subject of consultations between MoF and each local government unit in the course of the annual Budget preparation. Final allocations are notified within a week of the passage of the Budget by the Rada, which should take place by 1 December before the start of the new fiscal year.
	(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.	<b>A</b>	<b>A</b>	All revenues and expenditures of all government units at all levels pass through the Treasury system, and are reported in accordance with the same GFS/COFOG classification, so providing for full consolidation of all general government expenditure on a sectoral basis.
<b>PI-9</b>	Oversight of aggregate fiscal risk from other public sector entities.	<b>D+</b>	<b>D+</b>	
	(i) Extent of central government monitoring of AGAs and PEs.	<b>D</b>	<b>D</b>	SOE oversight is weak and fragmented. The CoM delegates its functions of SOE oversight to the line ministries and agencies as governing bodies for those enterprises not deemed to be of high national interest or of national security. The MoF does not perform an active or have a direct oversight function including debt oversight. While the MoF monitors the implementation of financial plans, it does not evaluate individual SOEs with regard to performance nor does it review the finances of SOEs. While SOEs supposed to have in place internal audit units, the government's internal audit service (KRU) in effect fills this role. The Accounting Chamber does not audit SOEs as its oversight role is limited to reviewing compliance with regard to the utilization of budgetary resources.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(ii) Extent of central government monitoring of SN governments' fiscal position.	<b>A</b>	<b>A</b>	The subnational governments operate through the Treasury and cannot expend more than their budget. Thus, the local budgets are part of the regular Treasury reporting. Only municipalities of certain size (over 500,000) can issue debt but Budget Code sets clear thresholds on the level of debt and debt service and MoF has to approve all debt issuance by subnational governments. Annual financial reports are consolidated national and subnational reports
<b>PI-10</b>	Public access to key fiscal information.	<b>B</b>	<b>B</b>	A complete set of documents is available to the public on the Parliament's web-site when the budget law is submitted to Parliament by the Cabinet of Ministers. The monthly and quarterly reports are prepared by the Treasury within days of period end and submitted to the Ministry of Finance which then publishes the reports. The yearend financial statements are made available to the public by March 1 of the following year, prior to audit by the Accounting Chamber. Contract awards are published on the web and in the Public Procurement Herald within 7 days after contract award. External audit reports are not published in full and resources available to primary service units are not public.
<b>C. BUDGET CYCLE</b>				
<b>C(i) Policy Based Budgeting</b>				
<b>PI-11</b>	Orderliness and participation in the annual budget process.	<b>B</b>	<b>B+</b>	
	(i) Existence of and adherence to a fixed budget calendar;	<b>B</b>	<b>B</b>	A clear budget calendar exists and is set out in the Budget Code. The call circular is issued in June with submissions due by the end of June. Ministries have 4 weeks to submit their budget proposals from the time of the call circular issuance. The calendar is generally adhered to. However, in 2009 the calendar was neglected and almost all the final stages including submission to the Parliament were completed with delay.
	(ii) Clarity/ comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent);	<b>B</b>	<b>B</b>	Both Cabinet of Ministers and Parliament approve annual budget guidelines prior to issuance which set out broad policy directions to be followed in budget development as well as consolidated levels of spending, revenue and deficit. Although policy officials are involved in the budget process, it does not include approval of the sector ceilings.
	(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years);	<b>C</b>	<b>A</b>	The legislature generally approves the budget before the beginning of the fiscal year. However, the Annual budget law for 2010 was approved only in April of 2010 due to Presidential elections and political conflict within the Government. 2009 and 2011 budgets were approved within the prescribed timetable.
<b>PI-12</b>	Multi-year perspective in fiscal planning, expenditure policy and budgeting.	<b>C+</b>	<b>C</b>	

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(i) Preparation of multi-year fiscal forecasts and functional allocations.	<b>C</b>	<b>C</b>	Until 2010 the Government used to submit to the legislature a forecast of the main macroeconomic and fiscal indicators by main categories of expenditures, revenues and financing for the upcoming three budget periods but without allocations by ministry. The new Budget Code of June 2010 introduced a medium term perspective into the budget process. Additionally to what was done previously, the Government is required to submit to the legislature estimates for the years t+1 and t+2 for each budget program that requires multi-year implementation.
	(ii) Scope and frequency of debt sustainability analysis.	<b>A</b>	<b>A</b>	The debt sustainability analysis is done once a year by the National Bank of Ukraine. The Ministry of Finance also does analysis of debt servicing and repayment schedule for the three years as part of the budget preparation annually.
	(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure;	<b>D</b>	<b>D</b>	No formal requirement exists for multi-year sector strategies. Some sectors have multiyear strategies (e.g., Transport) but only for capital expenditure without including recurrent spending implications. The system of state targeted programs exists in parallel, is not linked to sector, and although costed has a weak linkage to the budget process.
	(iv) Linkages between investment budgets and forward expenditure estimates.	<b>C</b>	<b>D</b>	Capital budgeting practice is weak. While line ministries do select capital projects/programs within their annual budget ceiling and are subject to financing availability, many of the elements of sound capital budgeting system are missing. The project selection and evaluation is weak and discretionary since they are not based on thorough economic analysis, and maintenance costs are generally not considered during the decision making process. Some major programs do have both recurrent and capital cost estimates linked to each other (e.g., Euro 2012).
<b>C(ii) Predictability and Control in Budget Execution</b>				
<b>PI-13</b>	Transparency of taxpayer obligations and liabilities.	<b>C+</b>	<b>C</b>	The indicator is scored separately for tax administration and customs service and then averaged to come up with the final score.
	(i) Clarity and comprehensiveness of tax liabilities.	<b>C(tax)/ C(customs)</b>	<b>C</b>	A new Tax Code was adopted in 2010 to replace numerous tax laws and to create a basis for comprehensive and coherent tax legislation. The adoption of the unified tax legislation has reduced the number of sub-legal acts and internal instructions on tax administration. Unfortunately, the Tax Code still contains number of tax privileges for sectors that might create distortion and erode a tax base. All privileges are provided as a temporary measure although some of them are valid till 2020. Tax accounting is based on budget classification approved by the MoF. The existing Customs Code, effective since 2004 has some drawbacks including that it is not fully aligned with Ukraine's WTO commitments. Regulations governing the majority of customs operations are elaborated in multiple instruments of secondary legislation. The methods of assessment are opaque, and difficult for importers to dispute; and there is too much room for discretionary decision-making in subsequent discussions about the levels at which the value and duty rate should finally be set.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(ii) Taxpayer access to information on tax liabilities and administrative procedures.	<b>B/C</b>	<b>C</b>	<p>Unified taxpayers accounts have not been introduced yet and should be in place upon completion of the State Tax Service Modernization Program financed by the WB. Taxpayers have an access to legislative acts and instructions through web-site and receive free software to submit tax returns electronically. According to the STS, the number of taxpayers who submit their tax returns via e-mail increased from 38,500 in 2008 to 95,200 in 2010. In 2007 the Call Center was established which operates based on the unified informational platform, and 1,153,000 consultations were given through the Center in 2010 compared with 798,400 in 2006.</p> <p>All customs legislation can be viewed on the Parliament website in Ukrainian. Information about customs regulations and procedures can be found on the SCSU website. Customs brokers and agents are currently the best source of information for importers and exporters about customs liabilities, regulations, and procedures. Access to information from brokers, however, is usually available only after the decision to import/ export has been made, and a contract agreed; it is not freely available in advance, as the basis for the decision itself. The SCSU does not publish its methods for assessing customs value.</p>
	(iii) Existence and functioning of a tax appeals mechanism.	<b>C/C</b>	<b>C</b>	<p>The tax appeals mechanism is functioning and up to 2010 has a 3 tier structure. Importers and exporters who disagree with a customs decision can appeal to the SCSU or the court for a review of that decision. For those businesses whose imports are not covered by a financial guarantee, the removal of disputed consignments from customs control, pending the appeal process, requires payment in advance of the full amount of duty assessed by the SCSU, and the subsequent application for a refund should the appeal be upheld. The alternative is for the goods in question to remain throughout the appeal process in a customs warehouse, effectively duty free.</p>
<b>PI-14</b>	Effectiveness of measures for taxpayer registration and tax assessment.	<b>C</b>	<b>C</b>	<p>The indicator is scored separately for tax administration and customs service and then averaged to come up with the final score.</p>

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(i) Controls in the taxpayer registration system.	C	C	<p>There is a unified business register for all taxes. VAT registration has been in place since 1997, and since 2005 is mandatory for businesses with annual sales over UAH 300,000. Voluntary registration was not regulated earlier. However the Tax Code has laid down rules for voluntary registration to prevent abuse of the system for refund fraud. Only businesses that have at least 50% of their transactions with VAT registered taxpayers can voluntarily register for VAT. The STS now can deregister firms if there is no activity for 12 months. It is too early to assess whether any significant improvement has taken place in controlling taxpayer registration and in reducing fraudulent actions by fictitious firms. Ukrainian importers and exporters are registered by the SCSU at the office closest to their principal place of business. The registration process requires the importer/exporter to visit the customs office, and present a range of documents, including the business' tax registration number. These details are recorded electronically, and transmitted to the SCSU main database, which automatically allocates a separate and unique customs registration number. Importers, and their customs brokers/agents, are assigned to a specific customs house, and a special application must be made to the SCSU for customs clearance at another location. This inflexible procedure restricts opportunities for consolidation (groupage) of import consignments and has a negative impact on trade facilitation.</p>
	(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations.	C	C	<p>Penalties for non-compliance exist however not very effective since a number of legislative features encourage appeals, delays and court proceedings. The new Tax Code has introduced changes to the system but the effect of implementation remains to be seen. The tariff of financial penalties for customs issues is set sufficiently high to act as a deterrent. However, the frequently suspect grounds upon which duty liabilities are assessed undermine the penalties applied, by virtue of the fact that these are calculated as a percentage of the assessment. There is a high risk that importers, knowing that these will be disputed by customs officials, will set declared import values as low as possible in order to establish bargaining room in the subsequent assessment process.</p>
	(iii) Planning and monitoring of tax audit and fraud investigation programs.	C	C	<p>Risk based audit selection has been implemented since 2009 for all planned audits. Risk factors are determined based on analysis of macro indicators, market intelligence and third party information. However in 2010 almost two thirds of all audits were unplanned which undermines usefulness of the risk based audit. Investigation of tax evasion is dealt with by the tax militia based on intelligence and third party information. The majority of customs fiscal controls are exercised in respect of import consignments, whilst the goods are still under customs control, either at the frontier or inland. The SCSU carries out post-clearance controls of importations on a significant scale, at the current average rate of 1,000 to 1,200 individual inspections per annum. These inspections, carried out at importers' business premises, are a mixture of planned and <i>ad hoc</i> controls, organised independently of audits arranged by the Tax Service.</p>

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
<b>PI-15</b>	Effectiveness in collection of tax payments.	<b>B+</b>	<b>D+</b>	
	(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).	<b>B</b>	<b>D</b>	Collection ratio for gross tax arrears was 83% in 2009 and 73% in 2010 which averages to 78%. The overall tax arrears as a share of tax revenues stood at 5.5% average over the same two years. This is a very substantial improvement from 2006 when the equivalent figure was 18%. The considerable share of the improvement could however be attributed to tax arrears restructuring, especially Nagtogaz. The Law recently passed by Parliament writes off the entire tax debt of Naftogaz. This would justify downgrading score to C or below on the first sub-dimension if the assessment was based on 2011 performance.
	(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	<b>A</b>	<b>A</b>	All tax and customs payments are paid to the account of the respective agency in the State Treasury and thus transfer is immediate. Information on payment is then submitted to the State Tax Administration.
	(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.	<b>B</b>	<b>D</b>	The STA reconciles revenue data with the Treasury of Ukraine according to the Ministry of Finance Order #317 of March 28, 2006. Reconciliation happens on the 1 <sup>st</sup> day of the month following the reporting one. However, the reconciliation is not full due to the fact that treasury accounts for revenues on a cash basis and thus does not capture tax assessments.
<b>PI-16</b>	Predictability in the availability of funds for commitment of expenditures	<b>C+</b>	<b>D+</b>	
	(i) Extent to which cash flows are forecast and monitored.	<b>A</b>	<b>D</b>	Ministry of Finance based on the inputs of the line ministries approves budget apportionment by month. The Treasury also provides monthly forecasts with daily cash flow estimates. The Treasury updates their annual projects monthly based on actual cash flows and submits to MoF so the Debt Department can plan their domestic debt issuance in advance. Treasury actively manages cash flow by setting dates for payment of regular expenditures, such as salaries, to match expected revenue inflows.
	(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.	<b>A</b>	<b>A</b>	MDAs know their annual budget and within one month of the approval of the budget, the MOF provides them with the annual apportionment by month and according to program and economic classification on cash basis. Treasury controls spending to the plans and apportionments. Full monthly cash releases are made for protected items of the state budget and weekly cash releases are made for unprotected spending items. The cash releases are based on apportionments as well as the commitments registered in the Treasury system as soon as they taken by the spending unit. The commitment module of the Treasury ensures that commitments are within allocations.



	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.	<b>C</b>	<b>D</b>	Adherence to budget allocations, according to the budget classification is effectively controlled through the automated Treasury system. Ministries can vire funds between programs and across time periods, within their overall budget ceiling, but with approval from the MOF. Reallocations between Ministries, and budget increases beyond the approved budget appropriation, require parliamentary approval. These cases are dealt with on an ad hoc basis and mainly relate to priority programs (e.g. Euro 2012). Annual budget laws were amended 14 times on average in 2010 and 2009.
<b>PI-17</b>	Recording and management of cash balances, debt and guarantees.	<b>B+</b>	<b>B</b>	
	(i) Quality of debt data recording and reporting.	<b>A</b>	<b>A</b>	Quality of cash and debt data recording and reporting arrangements is good. Ukraine is a regular member of SDDS system of the IMF and has to comply with criteria of regular reflection of key fiscal data. The State Debt Department is an integral part of the Ministry of Finance and maintains the database recording all state debt and sovereign guarantees.
	(ii) Extent of consolidation of the government's cash balances.	<b>B</b>	<b>B</b>	The use of a Treasury Single Account ensures that cash balances are reported on a consolidated basis. Only special accounts for donor funded projects are outside the scope of Treasury operations, which cover all transactions of the State, local budgets, Pension Fund and other social insurance funds. The set up of the TSA is regulated in the National Bank Law.
	(iii) Systems for contracting loans and issuance of guarantees.	<b>B</b>	<b>C</b>	MOF approves all the borrowings and guarantees. Limits exist on both state debt and state guaranteed debt. These limits are set annually by the Budget Law. The Budget Code defines cap on local debt service as a 10% of general fund expenditures and are limited to municipalities with population of over half a million. The Budget Code sets principles for granting state guarantees. The annual Budget Law specifies the maximum amount of guarantees to be granted as well as list of investment programs for which the state guarantees could be granted. Government resolutions define procedure for granting guarantees.
<b>PI-18</b>	Effectiveness of payroll controls.	<b>D+</b>	<b>D+</b>	
	(i) Degree of integration and reconciliation between personnel records and payroll data.	<b>D</b>	<b>D</b>	Each Ministry is responsible for maintaining its own payroll system often as a module of an integrated accounting package. Personnel records are still largely manual. Treasury acts as banker to the line ministries, making electronic payments to employees through the centralized automated Treasury system. With personnel, payroll and payment information in many separate systems, some automated and some manual the level of integration is low and reconciliation difficult.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(ii) Timeliness of changes to personnel records and the payroll.	<b>C</b>	<b>C</b>	Previous analysis indicated that it takes up to three months to update payroll to reflect changes in personnel information to update payroll, with the result that there are frequent retrospective adjustments to the payroll. However, the decentralized nature of payroll management means there could be considerable variations in performance across ministries which are difficult to assess across the government.
	(iii) Internal controls of changes to personnel records and the payroll.	<b>A</b>	<b>A</b>	Ministries have clear detailed rules and procedures governing changes to personnel and payroll information, supported by authorizing signatories and an audit trail.
	(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.	<b>A</b>	<b>A</b>	Ministries have clear detailed rules and procedures governing changes to personnel and payroll information, supported by authorizing signatories and an audit trail.
<b>PI-19</b>	Transparency, competition, and complaints mechanism in procurement.	<b>C+</b>	<b>D+</b>	Change in indicator methodology results in different dimensions of the indicator. Please see the main text of the report for details.
	(i) Transparency, comprehensiveness and competition in the legal and regulatory framework.	<b>B</b>		The public procurement is regulated by the Public Procurement Law which has the precedence over the sublegal acts in this area. The implementation arrangements are set by the Government resolutions while some methodological issues are regulated by the Ministry of Economy orders. Currently the PPL provides for some exemptions. The PPL provides for application of specialized laws in some specific cases; however this specialized legislation is still under development (in particular the law regulating procurement by Utility companies).
	(ii) Use of competitive procurement methods.	<b>C</b>		Open competition is the main method of procurement. However, current wording allows for direct contracting in "urgent cases". Urgency is not defined and this provision can be misused, for example when procurement is not done in a timely manner, thereby creating an "urgent" situation allowing the procuring entity to for authorization to contract on a single source basis.
	(iii) Public access to complete, reliable and timely procurement information.	<b>A</b>		The law stipulates that all information related to public procurement is publicly available. Government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints are publicly available on the web site of the authorized agency accessible upon free registration and in a printed edition.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(iv) Existence of an independent administrative procurement complaints system.	<b>D</b>		Score D for dimension 4 is related to change in methodology and not deterioration of the complaints resolution mechanism, On the contrary, establishment of the independent complaint resolution body under the Anti-Monopoly Committee was one of the key developments that strengthened the procurement framework AMC hosts the independent complaint body which reviews all complaints about public procurement. The Complaint Resolution Board has 3 members, including the Chief of Board who are independent of all procurement transactions and award decisions. The decision of the Board can be appealed in Kiev administrative Court. The procedure is defined in the PPL and AMC Manual on Complaints Resolution. The PPL prohibits contract conclusion during the period of 14 days when the complaint should be submitted. The complaints on the Bidding Document should be submitted before the deadline for bids submission. The complaints system does not include representatives of the private sector and civil society.
<b>PI-20</b>	Effectiveness of internal controls for non-salary expenditure.	<b>C+</b>	<b>C+</b>	
	(i) Effectiveness of expenditure commitment controls.	<b>B</b>	<b>B</b>	The Treasury system, applied across government at all levels, includes a module whereby commitments should be registered before orders are placed or contracts concluded, and will only be accepted if they are within the budgetary provision of the spending unit. Under this system commitments cannot extend beyond the current budget year, and if not already provided for would require virement authorisation or new appropriations. Where projects extend beyond the initial year, it is understood that the Treasury keep a separate record of prospective expenditure beyond the budget year, but there is no assurance that sufficient budget will be allocated in future.
	(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.	<b>C</b>	<b>C</b>	The STU maintains a manual on technical procedures in which all Treasury instructions are put into operational context. In 2004 the Ministry of Finance issued Order 136 in which it outlined the relevant definitions and procedures for <i>commitment</i> accounting. In 2006 the commitment registration and control process was supported by an automated module integrated with the Treasury system which reportedly has had a considerable impact on budgetary discipline. It has not been possible to secure systematic evidence about the extent of compliance by spending units with the commitments registration system.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(iii) Degree of compliance with rules for processing and recording transactions.	C	C	SFI and ACU identified numerous errors and compliance failures, although their reports do not identify the nature of and reasons for these failures. In some cases these failures took the form of breaches of technical rules, for example by the debiting of special fund to meet expenditure properly charged to the general fund. This was attributed primarily to the pressures on managers to meet non-discretionary recurrent costs of protected expenditure items at the expense of discretionary investment and maintenance spending. In other cases they arose through management over-ride of the minimum requirements for supporting documentation before payments were executed. Although the actual payments are made electronically into bank accounts, there is a scope for manual intervention in the earlier stages of the process and much depends on the vigilance of Treasury staff to spot deficiencies.
<b>PI-21</b>	Effectiveness of internal audit.	<b>D+</b>	<b>C+</b>	
	(i) Coverage and quality of the internal audit function.	D	C	<b>Internal audit as defined by international standards (IIA or IAASB ) was not effectively operating in Ukraine in 2010.</b> A decentralized internal audit function was being developed based on the 2007 White Paper on Public Internal Financial Control (PIFC), but internal audit units were established only in 2011. The new Budget Code and Presidential Decrees 499 and 504/2011 have laid the foundations for the regulatory framework upon which internal audit can be built. A small part of State Financial Inspection's (SFI) work (around 3%) is performance audit, which has some of the characteristics of systems monitoring. The current rating should not be seen as indicating deterioration since 2006 but rather as a more accurate assessment of the status of internal audit in Ukraine, based on clear distinction between the nature of SFI's work and that of an internal auditor.
	(ii) Frequency and distribution of reports.	C	A	SFI report on inspection and audit activities are not transmitted to the SAI. For this reason the rating for the second dimension cannot be higher than C. The SFI annual report provides a summary of the numerous and frequent reports submitted to the Cabinet of Ministries, the volume of funds in violation of rules and procedures, action taken to recover inappropriately spent funds, and the number of public officials subjected to disciplinary measures.
	(iii) Extent of management response to internal audit findings.	B	B	According to SFI 2010 report, out of 3,700 recommendations issued there have been 922 "management decisions". The report does not specify the subject or purpose of these management decisions. This reflects the role of SFI as an inspection body with power to impose sanctions and corrections.
<b>C(iii) Accounting, Recording and Reporting</b>				
<b>PI-22</b>	Timeliness and regularity of accounts reconciliation.	<b>A</b>	<b>A</b>	

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(i) Regularity of bank reconciliations.	<b>A</b>	<b>A</b>	For central government, nearly all expenditure and revenue transactions are executed via the STA and the Treasury performs daily reconciliations of flows and balances. MoF Order #263 defines the periodicity, frequency and content of managerial reports – there is daily reporting of accounts along budget classification classes 1-4; monthly and quarterly reporting of accounts along budget classification classes 1-9 as well as off-budget sheet accounts.
	(ii) Regularity of reconciliation and clearance of suspense accounts and advances.	<b>A</b>	<b>A</b>	There are no suspense accounts in use in Ukraine. Advances are authorized only for specific types of contracts (usually construction) and are limited to 30-40% of the total value of the contract, depending on contract terms. Once the advance payments are executed, spending units are required to demonstrate and submit documentation reporting on the use the advance prior to subsequent payments being executed. This reconciliation (or documentation) is required to be submitted within one month of execution of the advance payment. If this is not completed by the spending unit, the treasury withholds further payments against the contract and these contracts are noted in the monthly/quarterly reports.
<b>PI-23</b>	Availability of information on resources received by service delivery units.	<b>B</b>	<b>B</b>	Local service delivery units (e.g., schools, hospitals) do not operate their own bank accounts. All revenues, including revenues collected through community contributions are managed and controlled by the Treasury. The front line service delivery units receive information on resources from departments of healthcare or education at the regional level upon approval of the local budget.
<b>PI-24</b>	Quality and timeliness of in-year budget reports.	<b>A</b>	<b>C+</b>	
	(i) Scope of reports in terms of coverage and compatibility with budget estimates.	<b>A</b>	<b>C</b>	Reports covering expenditures and revenues, as well as state debt, guarantees and obligations (liabilities and payables) are prepared regularly (monthly and quarterly). Quarterly debt reports include data on conditional and guaranteed debt obligations and liabilities.
	(ii) Timeliness of the issue of reports	<b>A</b>	<b>A</b>	The STU prepares monthly and quarterly reports of central government (revenues, expenditures, debt, liabilities and external loans) within 15 days of the end of the month and 35 days of the end of the quarter. The local government data is added and consolidated reports following the same breakdown are prepared within 25 days of the end of the month
	(iii) Quality of information.	<b>A</b>	<b>B</b>	The single treasury account executes all budget transactions (revenues and expenditures) for all central government ministries and central spending units. Additionally, the regional treasury branches execute budget transactions for local governments (including oblasts) and decentralized spending units. These arrangements enable a close and regular monitoring and reconciliation (including cross-checks) of financial information and flows.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
<b>PI-25</b>	Quality and timeliness of annual financial statements.	<b>C+</b>	<b>D+</b>	
	(i) Completeness of the financial statements.	<b>B</b>	<b>D</b>	The annual consolidated financial statements cover central and local government revenues, expenditures, government debt, financial assets, liabilities and obligations. There are however, important omissions from these consolidated statements – four extra-budgetary funds (pensions, social insurance, interim disability and employment insurance) are not included but also not part of the central government and do not affect the score.
	(ii) Timeliness of submission of the financial statements.	<b>A</b>	<b>A</b>	The government prepares its annual financial statements within four months after the end of the fiscal year. Each year, the Order of the MoF defines the specific timeline and process for the STU to follow in the preparation and submission of the annual financial statements and these deadlines have been met.
	(iii) Accounting standards used.	<b>C</b>	<b>C</b>	National accounting standards are applied for the annual financial statements. National standards are mostly cash-based, though there are some elements of accrual accounting such as reporting on assets and liabilities, debt, etc. These standards currently not compliant or aligned with IPSAS, though the government is currently developing new public sector accrual accounting standards which aim to be IPSAS-accrual compliant.
<b>C(iv) External Scrutiny and Audit</b>				
<b>PI-26</b>	Scope, nature and follow up of external audit.	<b>D+</b>	<b>D+</b>	
	(i) Scope/nature of audit performed (incl. adherence to auditing standards).	<b>D</b>	<b>D</b>	The main focus of ACU's work continues to be on ex post compliance control of expenditure from the State Budget in accordance with the remit in the 1997 law. It aims to cover all the government units within its mandate over a three year cycle. ACU's remit excludes revenue, local governments, extra-budgetary funds and SOEs, except to the extent that State budget funds are concerned, and has no role in relation to SOEs and extra-budgetary funds.
	(ii) Timeliness of submission of audit reports to legislature.	<b>B</b>	<b>A</b>	The ACU is required to submit a report on the annual budget execution statement produced by the Government to Rada within 2 weeks of its receipt. ACU meets this tight deadline, but the report in question is descriptive and based on audits conducted in the previous year. Overall Annual Report for the previous year is produced by the 1 <sup>st</sup> of December of the current year, but does not include discussion of the government's financial statements. Reports on specific audits are published throughout the year and transmitted to Parliament and Government.



	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
	(iii) Evidence of follow up on audit recommendations.	<b>B</b>	<b>B</b>	Formal response to audit findings and recommendations comes primarily from the audited government bodies and the Cabinet of Ministers who should reply within 15 days from receiving a report. The ACU's 2009 Annual Report states that bodies audited have in a number of cases taken the corrective measures required, and accepted the audit recommendations. A dedicated unit in ACU is responsible, among other things, for following up on actions undertaken by audited institutions in response to the Chamber's findings and recommendations.
<b>PI-27</b>	Legislative scrutiny of the annual budget law.	<b>C+</b>	<b>B+</b>	
	(i) Scope of the legislature's scrutiny.	<b>B</b>	<b>B</b>	The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. The Budget Code set responsibilities of the Parliament and Parliament Budget Committee. Currently Budget Committee composition has to reflect the overall Parliament composition in terms of party and fraction proportions. There are 33 MPs in the Budget Committee. There are also 30 civil servants working in the Secretariat of the Committee.
	(ii) Extent to which the legislature's procedures are well-established and respected.	<b>B</b>	<b>A</b>	The legislature's procedures are well established involve three readings of the annual budget law as well as prior review of broader fiscal policy as part of the budget circular approval. However, the procedures were not observed in relation to the 2010 Budget because of political disagreements against the background of a particularly difficult economic situation.
	(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).	<b>A</b>	<b>A</b>	The timing is adequate for legislature scrutiny. The legislature approves budget directions in May. The draft budget law is submitted to the Parliament by September 1. On October 20, first reading is conducted, based on which the Parliament send the Budget back to the Government with comments. By November 3, the Government has to submit revised Budget that is then again reviewed and approved in late November – December.
	(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	<b>C</b>	<b>A</b>	The Budget Code allows for amendments to the Budget in case of revenue targets not met. If the revenue targets deviate by 15% or more in any direction from planned based on quarterly report, Ministry of Finance initiates amendments to the annual Budget law. Article 55 provide for protected items allocation for which cannot be reduced in year. In year changes require amending the Budget law by the Parliament except for few cases. MoF has exercised a wide discretion to cut back allocations below the approved budget, without Parliamentary oversight, as happened during post crisis period (2009).

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
<b>PI-28</b>	Legislative scrutiny of external audit reports.	<b>D+</b>	<b>D+</b>	
	(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).	<b>B</b>	<b>B</b>	The review of audit reports is conducted within 6 months of the submission although not all reports are reviewed in sufficient detail.
	(ii) Extent of hearings on key findings undertaken by the legislature.	<b>D</b>	<b>D</b>	The Accounting Chamber of Ukraine (ACU) reports on the previous year's budget execution statement, within two weeks of its receipt from the cabinet of Ministers. These reports, which are analytical and do not rest on audit examination, are formally considered by the Rada in reaching its conclusions on the execution statement. There is currently no system in place to track the receipt and handling of audit reports. In-depth hearings are not being conducted.
	(iii) Issuance of recommended actions by the legislature and implementation by the executive.	<b>C</b>	<b>D</b>	According to ACU 225 audit results were sent to the Rada in 2009-10. The Rada endorsed 64 per cent of the 2009 reports, and 47 per cent of those made in 2010, with the remainder being simply noted by the Budget Committee. The focus of audit continues to be on compliance of specific transactions with applicable rules, rather than on identifying improvements in systems.
<b>D. DONOR PRACTICES</b>				
<b>D-1</b>	Predictability of Direct Budget Support	<b>D</b>	<b>NA</b>	
	(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).	<b>D</b>	<b>NA</b>	During the three years under review budget support outturn deviated from the forecast by more than 15%. Deviations have been mainly caused by delays in fulfillment of conditions for disbursement by the Government or by exchange rate depreciation and additional budget support at the end of 2008 as a result of fiscal crisis. At the same time, donors' programming and implementation cycles do not follow the Ukrainian budget calendar, making it difficult to assure predictability in estimated disbursement of funds.
	(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates).	<b>D</b>	<b>NA</b>	Comprehensive and timely forecasts, annual and by quarter, are not provided by all donor agencies. Release of the World Bank DPLs is linked to a satisfactory performance against institutional or policy actions making quarterly disbursement estimates not applicable. The European Commission is the only donor that provides both annual and quarterly disbursement schedules in its sector budget support financing agreements with the Government of Ukraine. This information is updated upon request by the Ministry of Finance during the annual budget preparation process in order to adjust multi-annual budgetary projections. However, during the period under review these quarterly forecasts were missed by more than 50% due to disbursement delays.

	Indicator	2010	2005	Explanation of scores, changes in scores and evidence
<b>D-2</b>	Financial information provided by donors for budgeting and reporting on project and program aid.	<b>D</b>	<b>D</b>	
	(i) Completeness and timeliness of budget estimates by donors for project support.	<b>D</b>	<b>D</b>	According to the Ministry of Finance, most donors do not provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification. The World Bank and the EC provide disbursement estimates. However, these estimates use donor formats, which do not follow the Government's budget classification and are not connected to the state budget calendar.
	(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.	<b>D</b>	<b>D</b>	As is the case of budget estimates, most donors do not provide reports on actual financial flows for their projects and programs. The government relies on its own reporting system through the Single Treasury Account for program aid, and through implementing agencies for projects. The MoF consolidates the information in the monthly budget execution reports. In the case of the World Bank, the government has access to the electronic system "Client Connection", which provides it with regular updates of actual disbursements, including a monthly disbursement summary. These reports are used for reconciliation between donor disbursement records and government project accounts.
<b>D-3</b>	Proportion of aid that is managed by use of national procedures.	<b>C</b>	<b>D</b>	More than 57% of total aid funds originally pledged to central government in the period 2008-2010 would be subject to national procedures due to the predominance of budget support in the total volume of aid to Ukraine. The share of the aid using national procedures transforms in C score for the indicator.

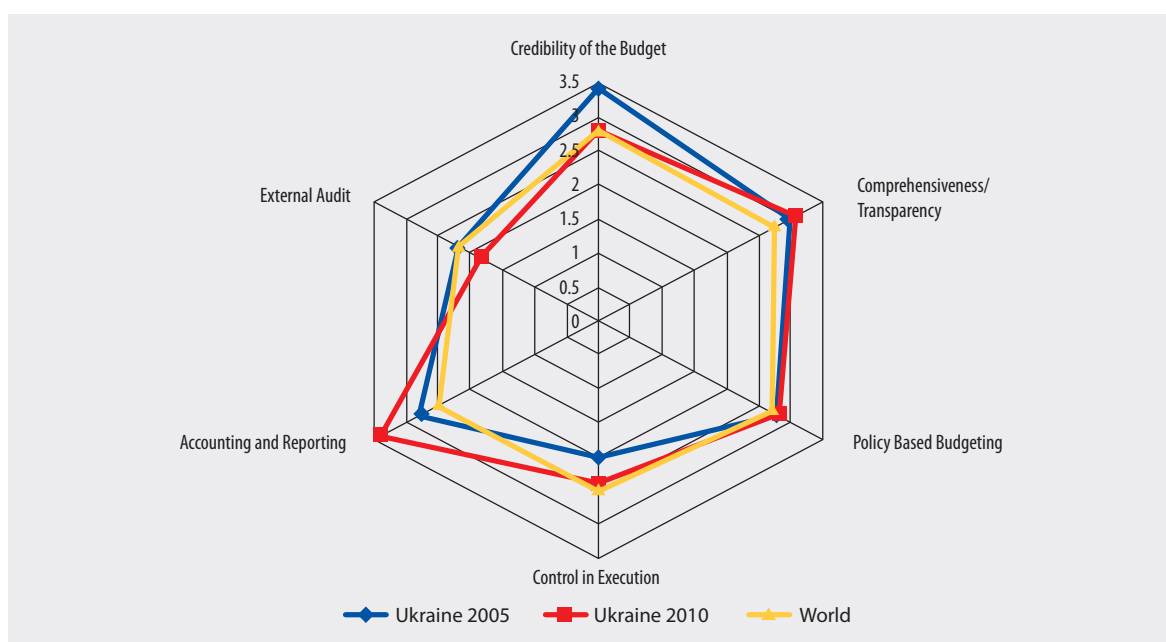
## Annex 2: PFM and Related Governance Comparators for Ukraine

1.1 In order to provide an international perspective on Ukraine's performance on public finance management, this section reviews Ukraine's scores relative to other countries, especially those in the same region and with similar income levels. Aspects of Ukraine's PFM performance are also compared with relevant PFM and related governance indicators, obtained from the Open Budget Index (OBI), Doing Business, Transparency International's Corruption Perceptions Indicator (CPI), the Global Integrity Index (GII), and the Business Environment and Enterprise Performance Survey (BEEPS).

### Comparisons using PEFA data

2.1 Taking the overall average of Ukraine's PEFA scores as the proxy for the quality of PFM, Ukraine scores 2.64 (converting PEFA scores to a 1-4 scale where 4 is the highest)<sup>13</sup>, which is equivalent to a score of C+. This indicates that the country has established fundamental PFM systems but there is plenty of scope for improvement. Ukraine rates above the worldwide average of 2.53, using the 114<sup>14</sup> national PEFA assessments conducted worldwide as a basis for comparison (Figure 1).

**Figure 1. Ukraine PEFA of 2005 and 2010 Comparison with World-wide Average**



**Source:** PEFA Assessments (2005-2010).

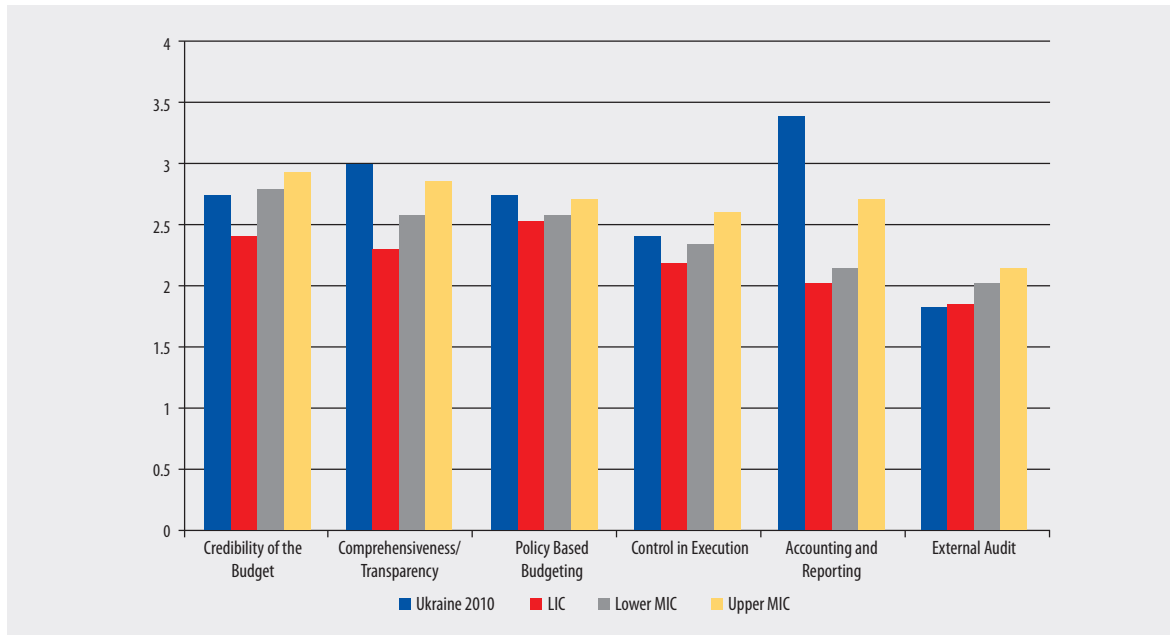
2.2 Compared to countries with an equivalent income level Ukraine also does well (Figure 2). Although it is classified as a lower middle income country (LMIC) Ukraine's performance is closer to the average of upper middle income countries (UMICs). Ukraine performed better than the average of UMICs in three dimensions; Budget Credibility; Comprehensiveness & Transparency; and Accounting, Recording and Reporting, achieving significantly better averages than UMICs in general. In general, similar LMICs score performance less well as they move through the budget cycle. By contrast Ukraine's performance

<sup>13</sup> All PEFA scores were converted to numerical values, accounting the numerical value of 4 for A; 3.5 for B+; 3 for B; 2.5 for C+; 2 for C; 1.5 for D+ and 1 for D.

<sup>14</sup> The PEFA assessments conducted between 2005 and 2010. If more than one assessment were conducted in one country, the most recent one is included. Of the 114 assessment, 40 were carried out in Sub-Saharan African countries, 15 in East Asia and the Pacific, 15 in East Europe and Central Asia, 26 in Latin America and the Caribbean, 11 in the Middle East and North Africa, 7 in South Asia. For comparison sake, Ukraine's assessments are excluded in these countries.

in downstream budget execution is good, especially in accounting and financial reporting, reflecting the strength of its centralized treasury system.

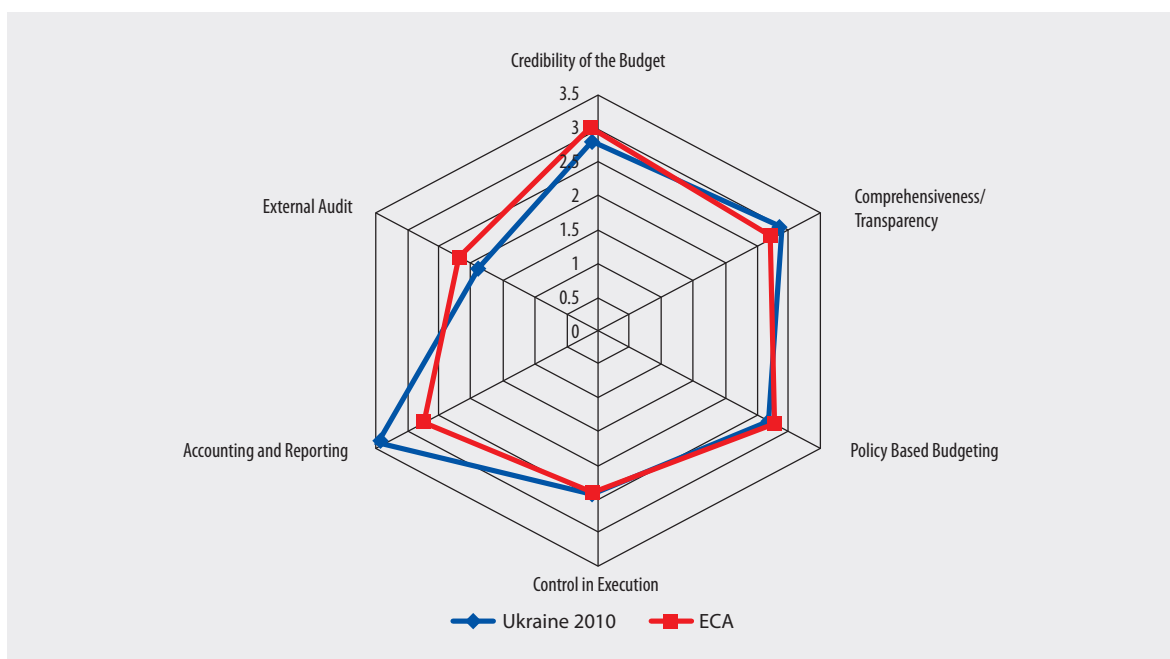
**Figure 2. Averages by Income Group and Budget Dimension**

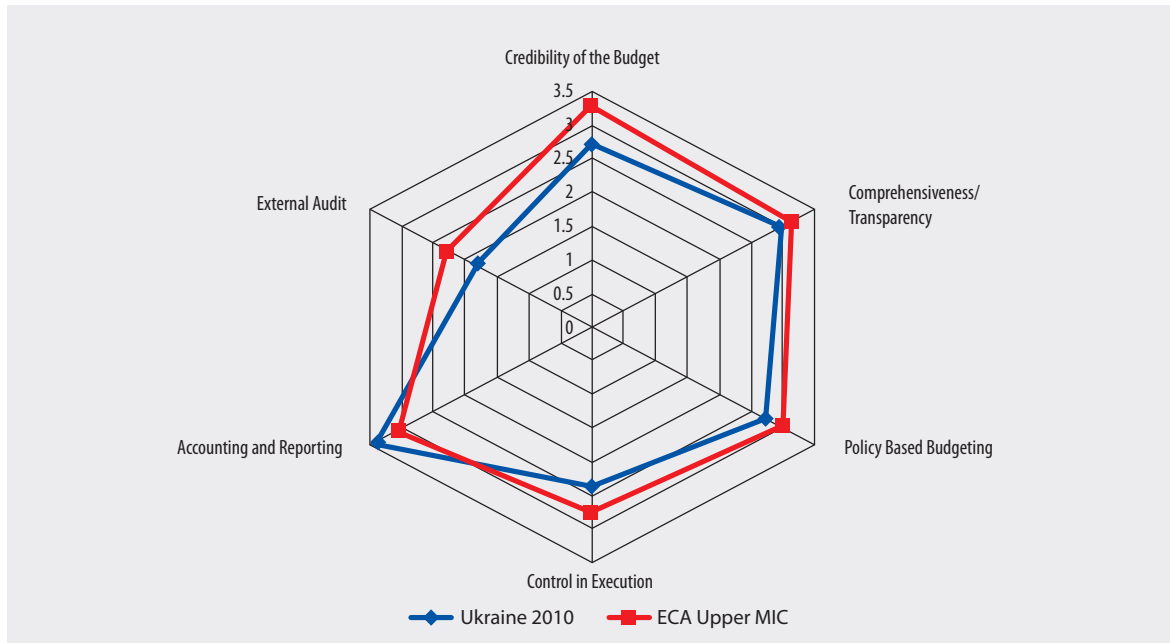


**Source:** PEFA Assessments (2005-2010).

2.3 Nonetheless, Ukraine's performance is less impressive when compared to neighborhood countries in Europe and Central Asia (Figure 3). Ukraine scores well compared to regional ECA average, outperforming on the dimensions of comprehensiveness and transparency, predictability and control in budget execution and accounting and reporting. Putting Ukraine into the context of the Upper middle income ECA countries, which is arguably a more appropriate comparator, given Ukrainian aspirations and potential, Ukraine is lagging behind on credibility of the budget and policy-based budgeting and scores as an average performer on the rest of the dimensions.

**Figure 3. Ukraine PEFA Assessment Compared with ECA and ECA Upper MIC Averages**





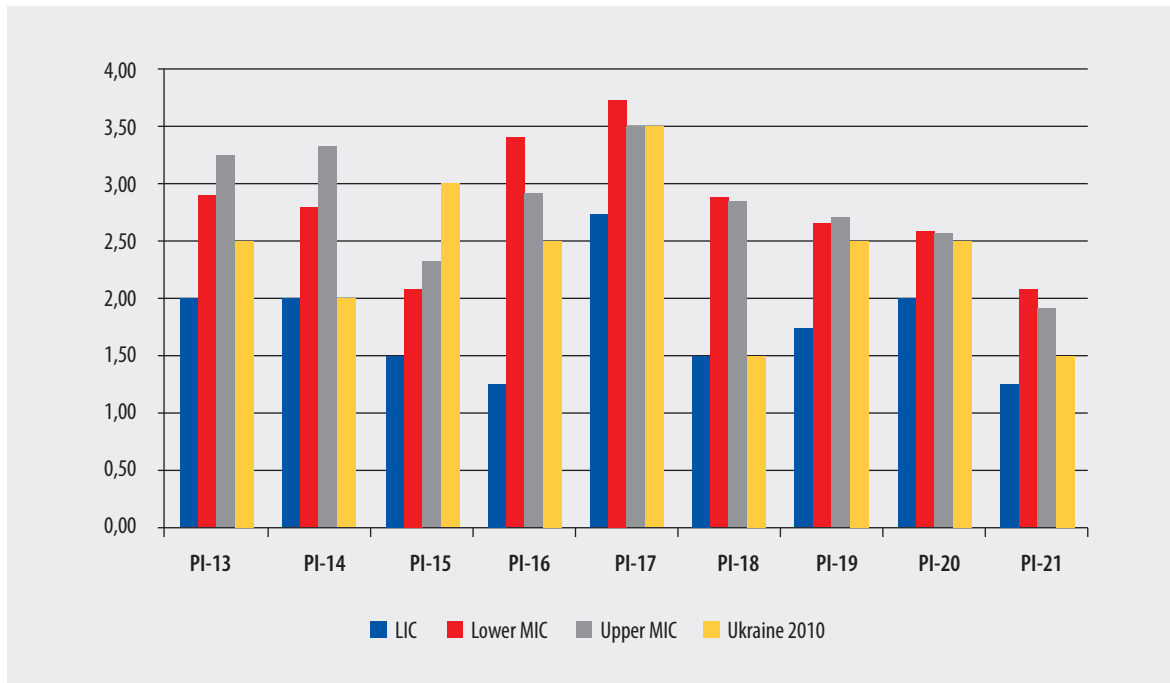
**Source:** PEFA Assessments.

2.4 However, it should be noted that the ECA Region is the best performer among the six World Bank regions, along with Middle East and North Africa, having an average score of C+ score (2.66), whereas the other regions score only C. The strong performance of ECA countries, including Ukraine, can be attributed partly to high levels of human capital and the existence of well-established centralized government systems. Automated Treasury systems are a common feature throughout the region which also underpins relatively strong performance in control of budget execution, accounting and financial reporting. Additionally, PFM reforms in many countries in the region received a strong boost from the EU accession process, although this is only reflected to a limited extent in the PEFA scores since none of the 10 EU member states in the Region has carried out a PEFA assessment.

2.5 Looking across the six dimensions of PFM performance (Figure 3), Ukraine performs well above the average in “Accounting, Recording and Reporting” and, despite setbacks since 2006, Ukraine still performs comparatively well on “budget credibility” and “budget comprehensiveness and transparency”. Under the current more stable economic and political conditions, Ukraine seems likely to regain its strong performance in these dimensions. External scrutiny and audit is the weakest dimension, undermined by the limited mandate of supreme audit body and limited parliamentary scrutiny. This dimension typically scores lowest on average in all regions of the World, but Ukraine scores below even the low world average.

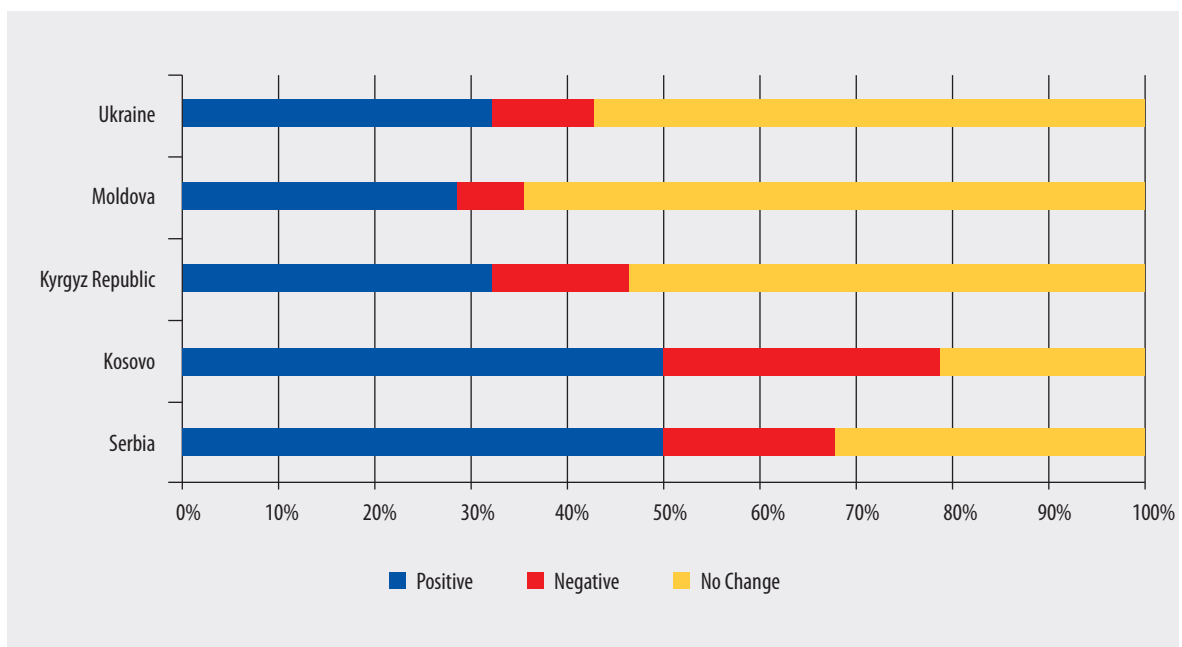
2.6 Together with Policy-based Budgeting and External Scrutiny and Audit, Ukraine’s performance on “Predictability and Control in Execution” is behind the regional average. Payroll controls (PI-18) and Internal audit (PI-21) are two particular weak spots in comparison to other ECA countries (Figure 4).



**Figure 4. Indicators of Predictability and Control in Budget Execution in ECA**

**Source:** PEFA Assessments (2005-2010) and Ukraine PEFA Assessment of 2011.

2.7 How does the Progress made by Ukraine since 2006 compare with that of other countries? Comparing the progress made by Ukraine between 2005 and 2010 against other countries in the region is constrained by the limited number of countries that have carried out repeat PEFA assessments on a similar timescale (Figure 5). Four other countries in the region have recently conducted recent repeat assessments and the changes in their PEFA scores are summarized below. Clearly the pace of improvement in Ukraine has been slow compared to these other countries.

**Figure 5. Comparison of Changes in Scores in Selected ECA Countries**

**Note:** Kosovo based on self assessment.

### Comparisons using related governance indicators

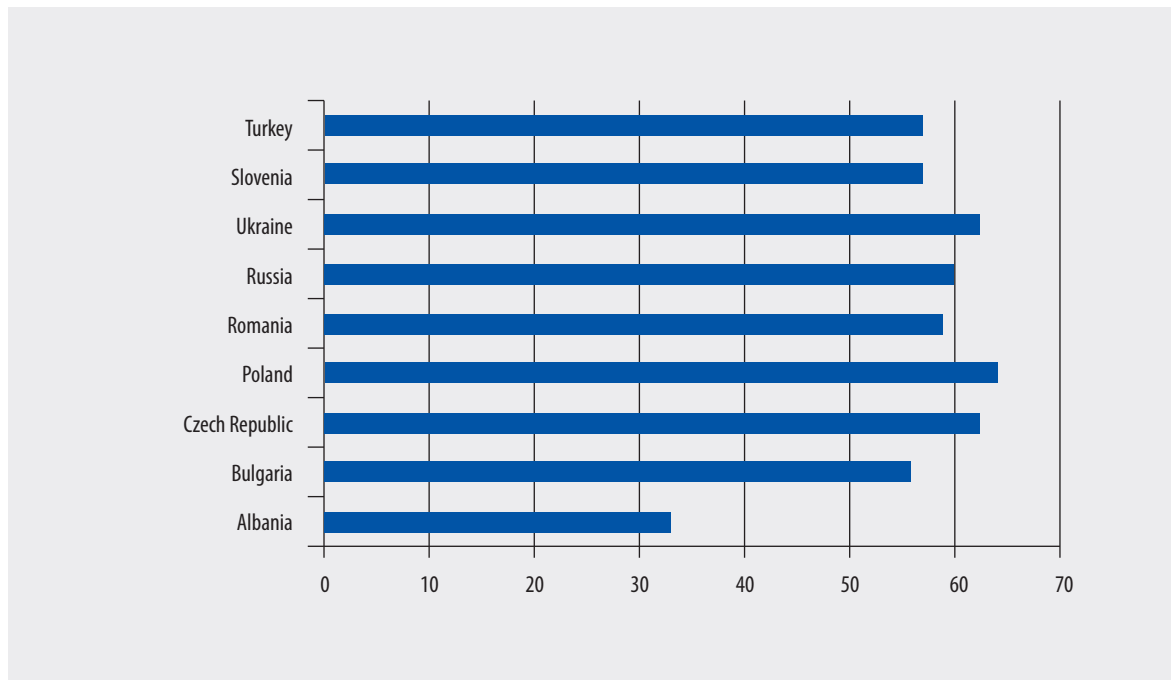
3.1 Several other worldwide and regional assessments and surveys, provide additional information on Ukraine's PFM performance that can be compared to the PEFA data, and provide additional detail complementing the PEFA assessment. This section reviews information extracted from:

- Open Budget Index (2010)
- World Bank "Doing Business" Survey (2010)
- Transparency International Corruption Perceptions Surveys (2006 to 2010)
- Global Integrity Index (2009)
- Business Environment and Enterprise Performance Survey (2008)

It should be noted that these indicators are mostly survey based and reflect perceptions of government performance – a different approach than PEFA which is based on observable performance indicators and results.

3.2 The **Open Budget Index** evaluates whether governments give the public access to budget information and provide opportunities to participate in the budget process at the national level. Civil society organizations collect the data for the Survey, which is conducted biennially. This can be compared to PI -10 which rates public access to key fiscal information. Open budget provides a broader perspective, including measures of public participation and availability of different types of information. The Open Budget Index (Figure 6) for 2010 ranks Ukraine more highly than PEFA, relative to other countries. Although Ukraine's PEFA score of B is good, OBI ranks Ukraine 19<sup>th</sup> in the World, putting it in the top tier of nations alongside Germany, Spain and India. Ukraine's OBI score has also improved significantly since 2006, while the PEFA score remains unchanged.

**Figure 6. Government Information to the Public in its Budget Documentation**



**Source:** Open Budget Index 2010.

3.3 The improvement in Ukraine's OBI score was largely because Ukraine began publishing a more comprehensive executive's budget proposal and started publishing in-year reports and an audited year-end report. Ukraine's public access to budget information could be improved further, with greater

involvement of the media and civil society in budget monitoring; producing a citizens' budget (i.e. a non-technical presentation of the government's budget); and by creating opportunities for the public to testify at legislative hearings on the budget. The OBI also suggested that a mid-year budget reviews be open to wider scrutiny.

3.4 The World Bank's "Doing Business" survey assesses the regulatory environment in which businesses operate. It is based on surveys of businesses and the latest survey was most recently updated in 2010. Its measure of the "ease of paying taxes" provides a useful comparator to PEFA indicators PI-13 and 14 that assess the transparency of taxpayer obligations and liabilities, taxpayer registration and tax assessment. Where PEFA assesses the effectiveness of the internal processes, Doing Business reflects the taxpayer's experience as a user of the service. Ukraine's high number of tax payments and the time spent in preparing and filing taxes (Table 1) makes the country one of the most difficult places in the world to pay taxes (181 out of 183 countries) according to the 2010 Doing Business Survey (Table 1).

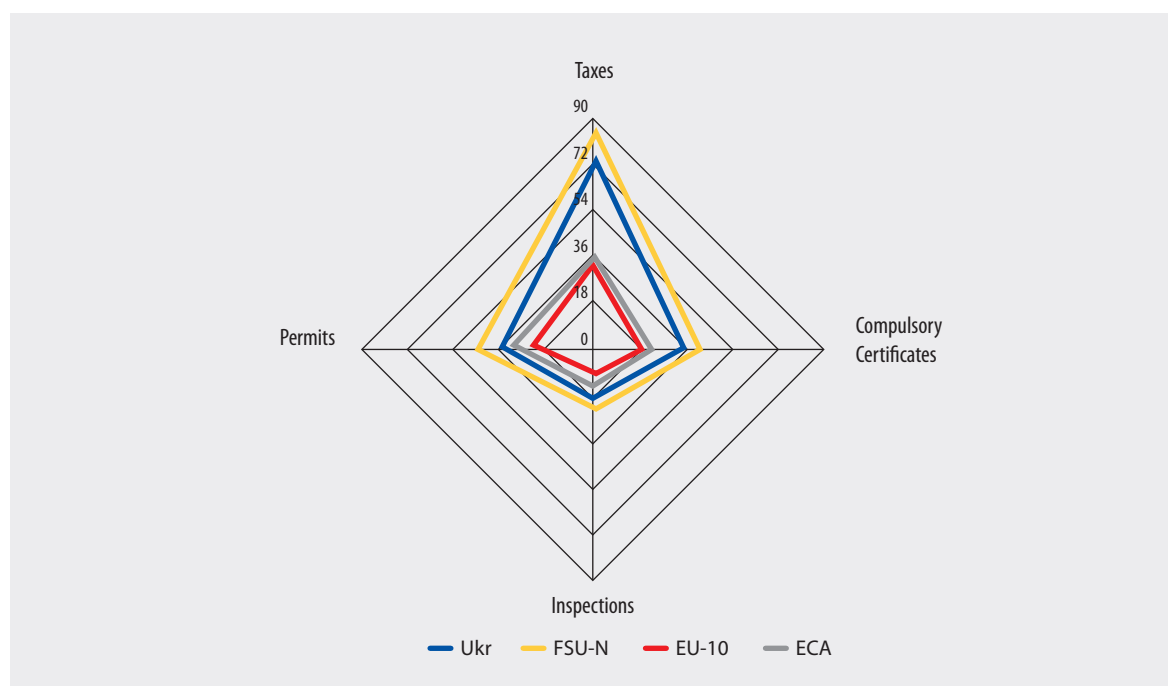
**Table 1. Administration Burden for Tax Payment**

	Payments (# per year)	Time (Hours per year)	Total tax rate (% of profit)
<b>Ukraine</b>	135	657	55.5
<b>ECA</b>	42	314	41.2
<b>LMI Countries</b>	35	359	40.3
<b>World Average</b>	30	282	47.8

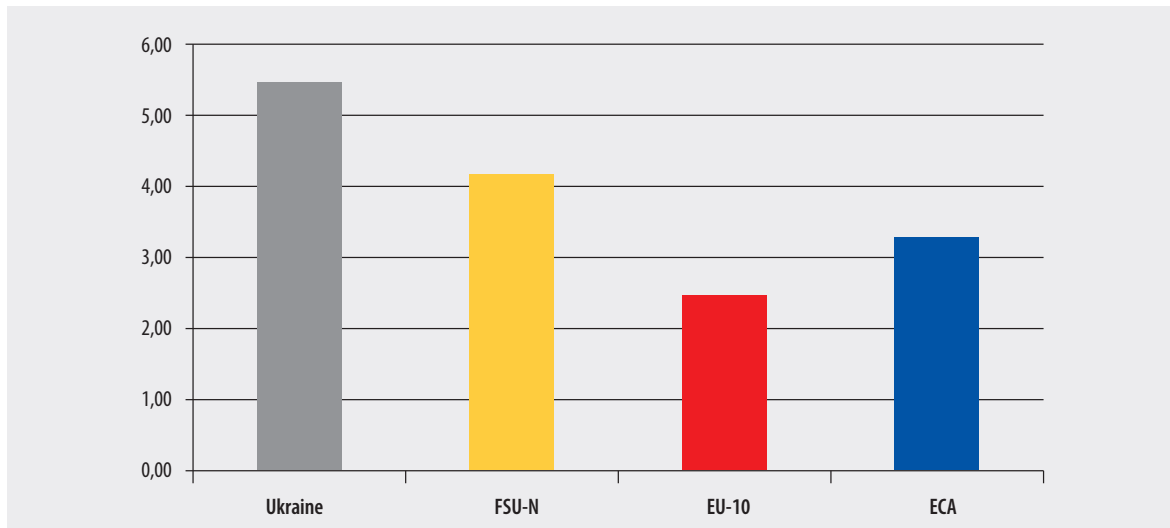
*Source: Doing Business 2010.*

3.5 Using a different tool, based on a survey of businesses direct experience, the Business Environment and Enterprise Performance Survey (BEEPS) measures the burden on business of compliance with the tax authorities (Figures 7 and 8). In terms of the total time spent dealing with the tax authorities Ukraine's performance was poor compared with the region as a whole, although around average for the FSU-N group of countries. The frequency of tax inspections was higher still relative to other countries in the region.

**Figure 7. Working Days Spent on Taxes and other government interactions**



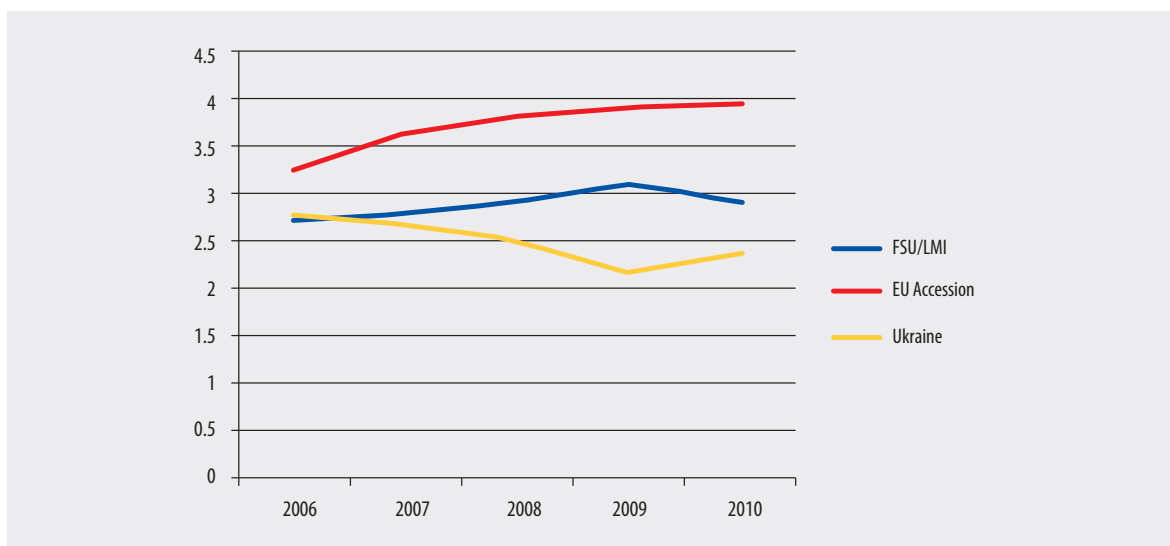
*Source: BEEPS 2008 Corruption Report.*

**Figure 8. Frequency of Tax inspections**

**Source:** BEEPS 2008 Corruption Report.

3.6 The divergence between the PEFA scores of C+ for PI-13 and 14 and the poor rankings in Doing Business and BEEPS may in part reflect the time needed for the effects of the improvements introduced in 2010 to be appreciated by businesses, but it also points up the need to create a culture of tax compliance, rather than frequent inspections and payment demands driven by revenue targets.

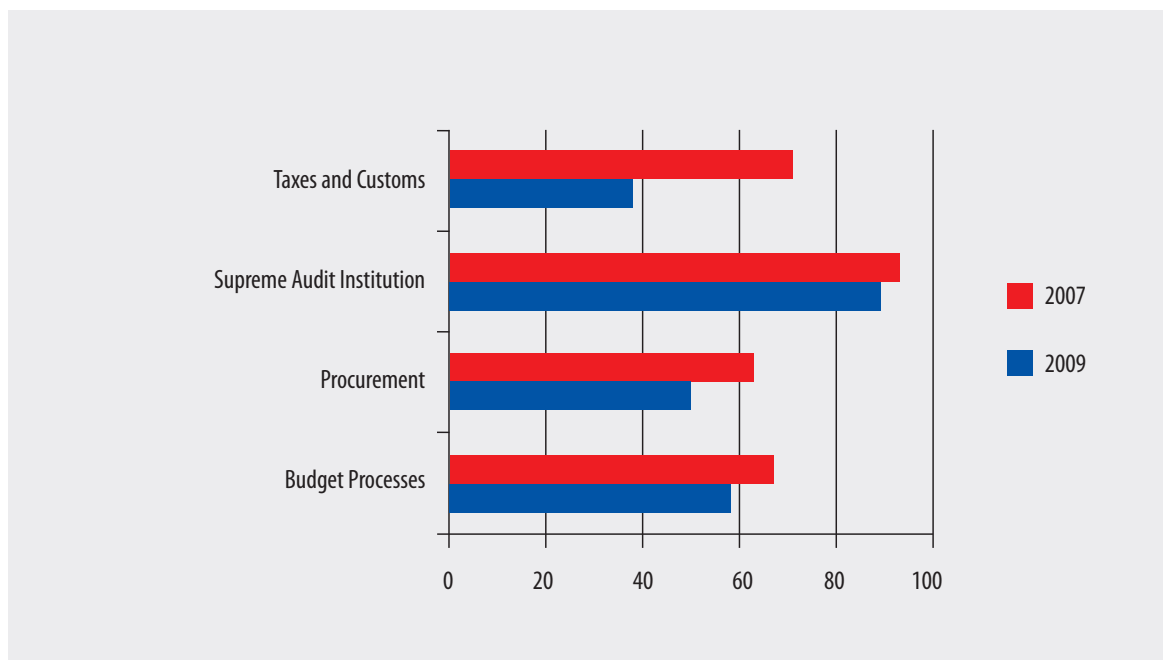
3.7 The **Corruption Perceptions Index** prepared by Transparency International is a broad composite measure of public perceptions of the prevalence of corruption in a country. It has been in existence for many years and is useful for tracking trends over time. Although there is no directly equivalent PEFA indicator, corruption reflects failings of PFM systems to prevent fraud and abuse of public resources. Weaknesses in tax administration, internal controls and procurement in particular are strongly correlated with increased corruption levels. In 2010 Ukraine ranked near the bottom at 134 out of 178 countries surveyed as compared with 99 out of 138 countries surveyed in 2006. Figure 9 below shows how perceptions have worsened since 2006 and despite some improvement since 2009 remain below the 2006 level. Within the region, the new EU members continued to show progress, as did the countries of South-eastern Europe and Georgia. Progress in the other FSU countries was more modest.

**Figure 9. CPI Score of Ukraine and other countries in the region**

**Source:** Transparency International Corruption Perception Index 2006-2010.

3.8 More detailed information about corruption perceptions, related to specific areas of PFM, can be found in the **Global Integrity Index** and **BEEPS** surveys. Although these report dates from 2008 and 2009 (and are therefore do not provide a fully up to date assessment) they do provide a good picture of where the system was most vulnerable to corruption during the 2006-11 period.

**Figure 10. Anti-Corruption Framework in PFM in Ukraine**



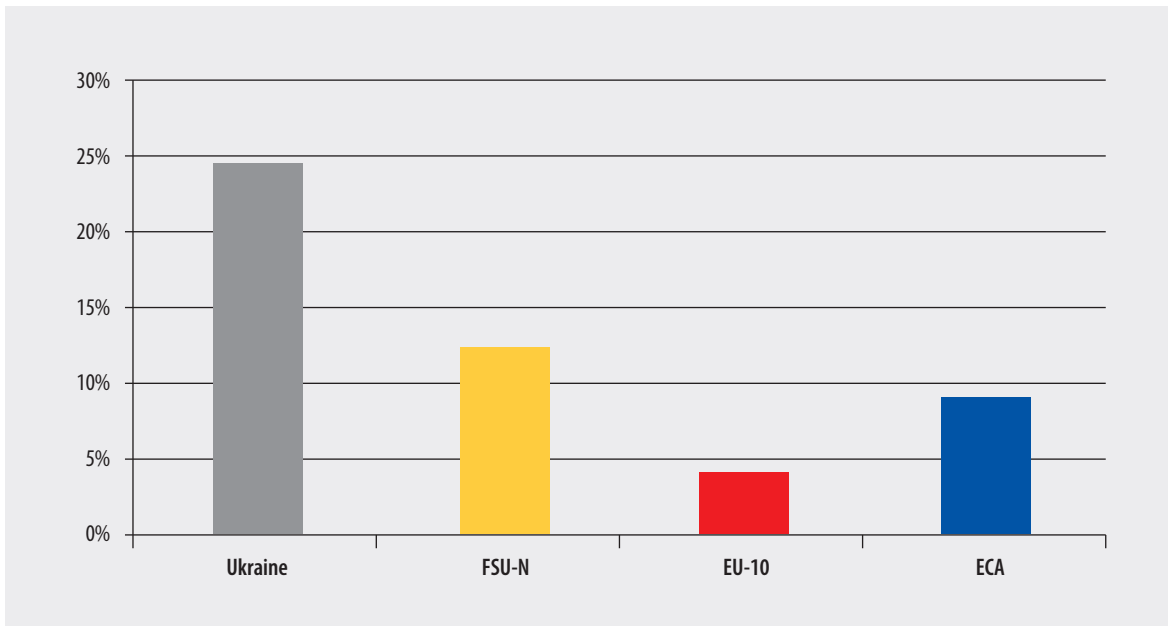
**Source:** *Global Integrity Index 2009.*

3.9 The BEEPS 2008 report on Ukraine contains information on payment of bribes to secure government contracts and to tax collectors. Changing these perceptions, as well as the underlying reality, will requires changes to the broader anti-corruption framework (including anti-corruption laws, ethics, investigations, enforcement and sanctions) which are beyond the scope of PFM system and of this assessment,

**Table 2. Percentage Paying Kickbacks on Government Contracts**

	Percentage of those who paid	No payment	Don't know	Refused	Total
<b>Ukr</b>	31%	49%	11%	9%	100%
<b>FSU-N</b>	25%	50%	10%	15%	100%
<b>EU-10</b>	13%	68%	11%	8%	100%
<b>ECA</b>	15%	64%	12%	9%	100%

**Source:** *BEEPS 2008.*

**Figure 11. Bribe Frequency: Dealing with Taxes/Tax Collection**

**Source:** BEEPS 2008.

It should be noted that any change in perceptions resulting from improvements in the tax code and the procurement laws in 2009 and 2012 would not be reflected in these surveys.



### Annex 3: Sources of Information: Interviews conducted

1. Serhiy Globenko, Head of Division, SOE finance and Property Relations Division, Ministry of Finance
2. Andriy Voznenko, Head of Unit, Industrial Finance Division, Ministry of Finance
3. Taras Tyvodar, Deputy Head of Division - Head of Unit, Agricultural Enterprises Finance Division, Ministry of Finance
4. Volodymyr Kryzhevsky, Deputy Head of Unit, Division of Transport Sector Finance, Ministry of Finance
5. Oleksandr Voznyuk, State Commissioner, Antimonopoly Committee
6. Sergiy Shershun, State Commissioner, Antimonopoly Committee
7. Olena Rybak, Head of Department supporting complaint resolution board, Antimonopoly Committee
8. Vladislav Zubar, Deputy director, Department of Public Procurement and State Order, Ministry of Economy
9. Natalya Shymko, Head of Unit, Department of Public Procurement and State Order, Ministry of Economy
10. Sergiy Rybak, Deputy Minister, Ministry of Finance
11. Viktoria Kolosova, Head of Division, Department of IFI cooperation and State Debt, Ministry of Finance
12. Olena Chechulina, Deputy Head, SFI
13. Maksim Timokhin, Head of CHU Division, SFI
14. Alexander Kotkalo, Deputy Head, State Tax Administration of Ukraine
15. Oleg Okryn, Deirector of Department, State Tax Service Modernization Department, State Tax Administration
16. Voktoria Litkovska, Deputy Head, Division of Cooperation with IFIs, Ministry of Finance
17. Andriy Hnatyuk, Deputy Head, Division of Administering and Monitoring Payments, Ministry of Finance
18. Vyacheslav Cherkashin, Deputy Head of Department, Department of Large Taxpayers
19. Lyudmila Kosmina, Deputy Head of Department, Department of VAT
20. Margarita Albina, Deputy Head of Department, Department of VAT Refund Control
21. Lyudmyla Slautina, Deputy Head of Department, Department of Legal Entities Tax Control
22. Sergiy Konovalov, Deputy Head of Department, Department of Appeal
23. Grygoriy Synytsya, Head of Division, Division of Lawmaking Coordination and Cooperation with Government Agencies
24. Yuri Marchenko, Head of Division, Division of Excise Administration
25. Ivan Romanov, Head of Department, Call Center Department

26. Natalia Tovsta, Budget Department, Ministry of Finance
27. Sergiy Latynin, Deputy Director, Department of Individuals Taxation
28. Lyudmyla Shkolna, Deputy Director, Department of Accounting and Reporting
29. Volodymyr Tarasenko, Deputy Director, Department of Repayment of Overdue Tax Liabilities
30. Borys Dziuba, Deputy Head, Main Tax Police Department
31. Inna Knyshenko, Budget Committee, Supreme Council of Ukraine
32. Svitlana Fischuk, Budget Committee, Supreme Council of Ukraine
33. Mykhailo Tolstanov, Department of International Cooperation, Accounting Chamber of Ukraine
34. Olga Romaniuk, Deputy Minister, Ministry of regional development, construction and housing of Ukraine,
35. Andriy Voytiuk, Senior Finance Unit, Kiev City Administration
36. Igor Burakovsky, Director, Institute of Economic Research
37. Galyna Karp, Director, Department of Territorial Budgets, Ministry of Finance of Ukraine
38. Igor Zhaman, Head of the Division, Education Department of Zhitomyr Oblast Administration
39. Anna Syvokonenko, Economist, Education Department of Zhitomyr Oblast Administration
40. Leonid Rudenko, Head of the Cardio Department, Main Emergency Hospital of Kiev

## Annex 4: Sources of Information: Documents consulted

1. Constitution of Ukraine
2. Budget Code № 2456-VI of July 8, 2010
3. Tax Code № 2755-VI of December 2, 2010
4. Law on Accounting Chamber № 315/96-BP
5. Public Procurement Law № 2289-VI of June, 2010
6. Law of Ukraine “On Management of State Assets № 2626-VI of October 21, 2010
7. A new draft law on Sovereign Debt and Sovereign Guarantees
8. Draft Law N. 8532 on Status and Prospects of Economic Relations with the EU (FTA) and Customs Union
9. Draft Law on Public Internal Financial Control (PIFC)
10. Law N 2222-IV on Amendments to Constitution of Ukraine of 8 December 2004
11. Resolution N.1149 of 8 December 2010 on Allocation of Intergovernmental Transfers
12. Decision N.20 rp/2010 of 30 September 2010 of the Constitutional Court
13. Presidential Decree #1085/2010 of December 2010 on Optimizing the System of Central Bodies of Executive Authority
14. Cabinet of Ministers Decree No. 955/ 08 as of August 2001 on Procedures for Planning the KRU Activities on Control and Revision
15. Presidential Decree 499/2011 of 28 April 2011 on State Financial Inspection of Ukraine
16. Cabinet of Ministers Decree no.59/January 2011 on Internal Financial Control
17. Presidential Decrees 504/2011 on Action Plan for 2011 to Implement the program of Economic Reforms for 2010-2014 “Prosperous Society, Competitive Economy, Effective State”
18. Cabinet of Ministers Resolution #506 of May 2009 on Conducting Financial Audit of Individual Business Transactions by the State Control and Revision Services of Ukraine
19. Cabinet of Ministers Resolution #1413-p of November 5, 2008 on the Strategy of State Statistics Development till 2012
20. Cabinet of Ministers Resolution #34 as of January 16, 2007 on the Public Sector Accounting Reform Strategy for 2007-2015
21. Cabinet of Ministers Resolution #170 of March 2, 2011 on the Medium-term Sovereign Debt Management Strategy for 2011-2013
22. Ministry of Finance Order #1024 of August 4, 2008 on Amendments to the Budget Classification
23. Ministry of Finance Order # 11 of January 14, 2011 on Budget Classification
24. Ministry of Finance Order #317 of March 28, 2006
25. Ministry of Finance Order #263 on Frequency and Content of Managerial Reports
26. State Treasury of Ukraine Order #39 on Reporting requirements by Budget Classification Classes

27. Ministry of Finance Order #11 (February 14, 2011) on Content and Format of In-year Budget Execution Reporting
28. Ukraine: Developing Medium Term Budgeting, IMF, April 2011
29. Public Finance Assessment in Ukraine, SIGMA Assessment Draft Report, July 2010
30. OECD Budget Review, OECD, 2011
31. Ukraine Public Finance Review: Creating Fiscal Space for Economic Growth, World Bank, Report #36671-UA, 2006
32. Improving Intergovernmental Fiscal Relations and Public Health and Education Expenditures Policy in Ukraine: Selected Issues, World Bank, Report #42450-UA, 2008
33. Open Budget Index, 2010
34. Doing Business, 2011
35. Business Environment and Enterprise Performance Survey, 2008

## Annex 5: Data tables supporting selected indicator assessments

Table 5.1: State Budget Expenditures (with Interbudgetary transfers) by Economic classification

	2008			2009			2010		
	Amended/ Final Plan	Actual	Execution, %	Amended/ Final Plan	Actual	Execution, %	Amended/ Final Plan	Actual	Execution, %
<b>Current expenditures</b>	<b>225,016.4</b>	<b>215,865.0</b>	<b>95.9</b>	<b>249,074.2</b>	<b>232,000.4</b>	<b>93.1</b>	<b>294,847.4</b>	<b>282,531.6</b>	<b>95.8</b>
Payroll	33,151.2	32,930.0	99.3	34,608.3	34,319.7	99.2	39,125.1	39,000.6	99.7
Payroll taxes	10,604.0	10,450.5	98.6	10,982.6	10,863.7	98.9	12,346.2	12,248.6	99.2
Medicines and bandages	2,025.5	1,880.9	92.9	2,521.36	2,499.37	99.1	2,324.7	2,248.6	96.7
Food	1,762.3	1,669.3	94.7	1,879.31	1,828.59	97.3	2,226.9	2,142.4	96.2
Utilities	2,730.6	2,631.7	96.4	3,165.98	3,104.02	98.0	4,527.2	4,164.3	92.0
Interest payments	4,565.1	4,418.8	96.8	12,855.0	9,907.3	77.1	16,656.0	16,639.5	99.9
Subsidies and current transfers to enterprises, institutions, organizations	26,696.5	24,814.6	93.0	20,858.6	18,498.3	88.7	22,023.7	20,370.5	92.5
Current transfers to other tiers of government	56,729.8	53,556.2	94.4	62,982.8	61,811.7	98.1	78,666.9	75,362.9	95.8
Current transfers to population	51,561.7	51,010.2	98.9	53,894.1	52,503.6	97.4	70,502.0	69,713.5	98.9
<i>pensions and allowances</i>	41,997.8	41,919.9	99.8	50,634.3	49,573.9	97.9	66,765.7	66,074.0	99.0
<i>stipends</i>	787.0	776.8	98.7	885.7	877.2	99.0	1,004.1	1,001.9	99.8
<i>other current transfers to population</i>	8,776.9	8,313.4	94.7	2,374.1	2,052.5	86.5	2,732.2	2,637.6	96.5
Other current expenditures	35,189.7	32,502.8	92.4	45,326.2	36,664.1	80.9	46,448.7	40,640.7	87.5
<b>Capital Expenditures</b>	<b>32,144.8</b>	<b>25,625.1</b>	<b>79.7</b>	<b>18,090.4</b>	<b>10,436.9</b>	<b>57.7</b>	<b>29,729.6</b>	<b>21,057.1</b>	<b>70.8</b>
Capital construction/acquisition	2,452.2	1,902.2	77.6	2,242.5	1,254.5	55.9	2,827.5	1,495.2	52.9
Capital repair and reconstruction	2,778.9	2,397.0	86.3	1,692.1	1,127.8	66.7	4,288.5	1,472.9	34.3
Capital transfers	21,006.5	16,437.9	78.3	11,163.4	5,968.0	53.5	18,813.8	15,111.0	80.3
<b>Unallocated expenditures</b>	<b>6,194.6</b>	-	-	<b>17,284.8</b>	-	-	<b>208.2</b>	-	-
<b>Total (including interbudgetary transfers)</b>	<b>263,355.8</b>	<b>241,490.1</b>	<b>91.7</b>	<b>284,664.8</b>	<b>242,437.2</b>	<b>85.2</b>	<b>324,785.1</b>	<b>303,588.7</b>	<b>93.5</b>

Table 5.2: State Budget Expenditures by Functional Classification

Expenditure by Functional Classification	2008			2009			2010		
	Plan	Actual	Execution, %	Plan	Actual	Execution, %	Plan	Actual	Execution, %
<b>Public Administration, including</b>	27,727.8	21,769.5	78.5	51,760.4	24,850.4	48	56,683.5	34,694.3	61.2
<i>Debt Service</i>	4,384.7	3,774.7	86.1	14,227.3	9,038.7	63.5	14,202.9	15,539.0	109.4
<b>Defence</b>	11,009.0	11,733.0	106.6	12,255.8	9,663.3	78.8	12,012.9	11,347.1	94.5
<b>Public Order, Security and Judiciary</b>	22,883.6	24,871.1	108.7	23,651.5	24,159.2	102.2	26,140.0	28,570.7	109.3
<b>Environmental protection</b>	2,115.3	2,230.2	105.4	1,492.2	1,824.3	122.3	2,002.6	2,292.7	114.5
<b>Housing and Communal</b>	982.7	444.0	45.2	101.9	270.6	265.5	49.0	844.4	1,724.00
<b>Healthcare</b>	7,266.1	7,365.5	101.4	6,738.3	7,535.0	111.8	7,418.4	8,759.0	118.1
<b>Spiritual and Physical Development</b>	3,027.3	2,917.6	96.4	2,335.8	3,216.7	137.7	2,615.7	5,165.5	197.5
<b>Education</b>	21,121.5	21,554.3	102	25,153.2	23,925.7	95.1	27,091.4	28,807.5	106.3
<b>Social protection and social security</b>	51,892.7	50,798.3	97.9	53,646.5	51,517.6	96	70,199.9	69,311.3	98.7
<i>Social protection of pensioners</i>	40,256.6	40,256.6	100	48,966.6	47,912.8	97.8	64,770.9	64,086.5	98.9
<b>Economic Activity</b>	42,469.3	38,693.0	91.1	35,537.6	33,294.3	93.7	23,120.6	36,030.0	155.8
<i>Agriculture, forestry, fishery</i>	10,894.8	9,494.7	87.1	5,811.7	6,185.0	106.4	5,277.2	7,208.3	136.6
<i>Fuel and energy</i>	16,214.7	15,386.3	94.9	6,181.9	11,932.6	193.0	6,188.9	12,024.4	194.3
<i>Transport</i>	11,713.7	10,461.7	89.3	11,497.4	11,627.8	101.1	7,640.8	12,608.4	165
<i>Other economic activities</i>	3,646.1	3,350.3	91.9	12,046.6	3,548.9	29.5	4,013.7	4,188.9	104.4
<i>Intergovernmental transfers</i>	62,712.4	59,113.6	94.3	61,483.2	62,180.1	101.1	80,414.2	77,766.2	96.7
<b>Total</b>	253,207.9	241,490.1	95.4	274,156.4	242,437.2	88.4	307,748.2	303,588.7	98.6



Table 5.3: State Budget Revenues

	2008		2009		2010	
	Plan	Actual	Plan	Actual	Plan	Actual
<b>Tax Revenues</b>	2,815,932,000	2,369,910,902	3,196,366,200	2,624,376,208	3,904,401,800	2,928,855,170
<i>PIT</i>	98,628,605,700	92,082,618,591	94,839,598,900	84,596,655,849	107,135,191,300	86,315,915,750
<i>EPT</i>	11,133,120,000	10,124,955,337	19,262,021,400	17,584,549,714	25,342,000,000	23,019,888,823
<i>Natural Resource Use Fees</i>	2,573,125,400	2,553,002,841	4,387,360,000	3,690,001,223	4,374,000,000	4,600,812,585
<i>VAT</i>	583,914,000	575,275,445	449,578,000	459,896,476	395,120,000	365,757,208
<i>Excise on domestic goods</i>	12,589,540,000	12,302,635,143	10,897,177,000	6,929,286,287	8,875,940,000	9,071,895,852
<i>Excise on imported goods</i>	418,000,000	418,707,399	508,000,000	461,071,691	561,833,000	599,855,951
<i>License fees</i>	47,352,386,700	52,854,202,481	57,368,617,700	50,676,764,216	55,278,788,700	65,067,725,207
<i>International trade taxes</i>						
<i>Other taxes</i>	5,396,744,400	2,125,318,857	2,460,356,000	1,060,057,302	785,917,000	586,957,023
<i>Nontax revenues</i>	95,343,700	135,241,282	838,040,100	645,285,020	680,464,300	305,642,182
<b>Revenues from operations with capital</b>	773,506,600	1,022,702,529	424,881,400	633,573,751	537,147,100	1,157,970,625
<b>From foreign Government and International Organization</b>	224,508,767,600	224,020,910,381	236,568,140,900	201,931,320,250	247,905,815,100	233,990,485,156
<b>Targeted Funds</b>	<b>231,931,966,700</b>	<b>231,722,888,522</b>	<b>245,309,356,400</b>	<b>209,700,329,048</b>	<b>254,995,704,100</b>	<b>240,615,241,081</b>
<b>Total revenues without interbudgetary transfers</b>	2,815,932,000	2,369,910,902	3,196,366,200	2,624,376,208	3,904,401,800	2,928,855,170
<b>TOTAL REVENUES</b>	98,628,605,700	92,082,618,591	94,839,598,900	84,596,655,849	107,135,191,300	86,315,915,750