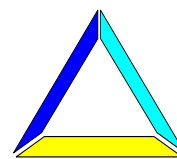


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# **DIAGNOSTIC REPORT<sup>1</sup>:**

## **FISCAL TRANSPARENCY AND OPENNESS IN UKRAINE<sup>2</sup>**

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<sup>2</sup> The report analyses relevant Ukrainian legislation active for July 2003.

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# 1. GENERAL GOVERNMENT ORGANIZATION

## 1.1. Legal definition of general government<sup>3</sup>

According to the Constitution of Ukraine, state power is exercised via its division into legislative, executive and judicial branches (Art 6). Government is represented by central and local bodies. Local self-government is defined as the right of a territorial community, residents of a village or a voluntary association of residents of several villages into one village community, residents of a settlement, or a city to resolve independently the issues of local character within the limits of the Constitution and the laws of Ukraine (Art. 140). The Decree "On Actions for Implementing the Concept of Administrative Reform of Ukraine", defines state (central) government as "an activity of the state to influence through executive power those spheres and industries of public life that require some state intervention. At the same time, the state governance is conducted beyond the bounds of executive power, for example, at the level of state enterprisers, establishments, or organizations".

The legislation of Ukraine does not define *general government* explicitly. However, this definition could be derived basing on the assignment of responsibilities in the Budget Code.

Hence, the following organizations are included into *general government*:

1. Central State government bodies (the legislative and executive bodies, the President of Ukraine, bodies of judicial power, bodies that conduct international activity (namely embassies and councils) and local self-governmental bodies).
2. Entities created by central bodies of state and local government including:
  - Educational state-owned units, including specialized schools (e.g. boarding schools and boarding schools for orphans and children without parents' care); secondary social rehabilitation schools; vocational education; higher educational units; post-graduate education, extra-curriculum educational establishments, pre-school education; general secondary education (schools with kindergartens), lyceums, gymnasiums, collegiums, evening (shift) schools; educational establishments for citizens requiring social assistance and rehabilitation; children's houses, family-type children's houses.

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<sup>3</sup> General Government defined in the SNA as the following group of resident institutional units:

- (a) all units of central, state, or local government;
- (b) all social security funds at each level of government;
- (c) all non-commercial, nonprofit institutions that are controlled and mainly financed by government units.

The sector does not include public corporations, even when the equity of such corporations is owned by government units. It also does not include quasi-corporations that are owned and controlled by government units. However, unincorporated enterprises owned by government units that are not quasi-corporations remain integral parts of those units and, therefore, must be included in the general government sector.



- Health-care state-owned units, including units of primary medical and sanitary aid, out-patient and in-patient aid (clinics of research-and-development institutes; hospitals, centers, leprosariums; hospitals for war veterans; specialized medical and sanitary departments clinics); specialized and general dental clinics, sanatorium-and-resort aid, sanitary-and-epidemiological supervision (sanitary/epidemiological stations, disinfecting stations; anti-epidemic activities primary), ambulatory centers, first-aid and obstetrics centers and stations, maternity homes, emergency stations, and ambulatory centers.
  - State-owned units for culture and art, including respective units of cultural and educational programs (libraries, museums, exhibitions, national parks; state cultural-and-educational activities, children's esthetic schools); theatre/show programs (theatres, national philharmonic societies, national and state musical collectives and companies and other establishments related to arts; non-for-profit national organizations of culture and art; state programs to support cinematography; state archives, state programs to support television, radio broadcasting, press, book publishing, and informational agencies; palaces and buildings of culture, clubs).
  - R&D units that conduct projects of national importance.
  - Physical training units
  - Physical training and sport units including state programs to train the reserve and main national teams; national teams; state programs on sports for disabled and rehabilitation; sport schools for children and youth of any type.
  - Social security units
  - National units of non-profit organizations of invalids, national organizations which activities related to children, youth, women, and families, state social security programs (hospices for adolescents; territorial centers and departments for home-care social assistance); state social protection programs (benefits to war and labor veterans).
  - Legal entities that are created for performance of public tasks and programs.
3. Social insurance funds: Fund of Compulsory State Social Insurance Against Unemployment; Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease; Fund of Compulsory State Social Insurance Against Temporary Working Disability; Pension Fund.

Therefore, general government covers almost all public sector units with the exception of state enterprises and corporations. Hence, it is compatible with SNA standards.

## **1.2. Organizational units covered by state budget and local government budget**

According to Budget Code of Ukraine, *budget entity* is a body, entity, or organization defined in the Constitution of Ukraine or an establishment /organization formed in compliance with the established order by a body of state power, body of power of the Autonomous Republic of Crimea, or local self-governmental body that is financed entirely from state budget or local budget. Respectively, budget entities are non-profit units. (The feature of non-profitability is defined in the Order of STA # 355).



All budget entities are legal units. Budget entities are spending units. System of spending units has a hierarchical structure. The Budget Code defines two levels of spending units: main spending units, and spending units of a lower level. The list of main spending units has to be approved by State Budget Law in a way of establishment of budget appropriations. The list of main spending units of a local budget is established by a budget decision of a local council (rada). Parliament (Verkhovna Rada), local councils, Cabinet of Ministers (CMU), central executive bodies, specialized courts or bodies that are specially empowered by aforementioned entities belong to main spending units. Spending units of a lower level are defined within the scope of responsibilities of main spending units (Art 21.22) and are represented by budget entities subordinated to aforementioned bodies.

The reorganization or liquidation of central executive bodies is decided by the President on the submission of the Prime Minister of Ukraine, ministries and other central executive bodies, acting within the limits of funding envisaged for their maintenance. The reorganization, creation, or liquidation of subordinated organizational units is decided by the respective unit of a higher hierarchical level (#773/2000 art. 86.14).

*The employment limit* for a central body is set by the resolutions of Cabinet of Ministers of Ukraine. In particular, employment limit for staff of central executive bodies and subordinated local bodies is set by the resolution of CMU #403, for diplomatic services - by the Decree of CMU #508-p, for court of appellate jurisdiction - by the resolution of CMU #572-p, for bodies of local state administrations - by the resolution of CMU #380. The employment limits for budget entities that belong to central government are approved by a respective central body. Employment of other units is not explicitly limited, however, the limitations are set indirectly by approving their budgets including wage funds and/or respective standards (for example, minimum number of teachers per 10 children at school).

Labor remuneration is approved by the head of a respective budget entity according to legislative and other normative acts of Ukraine, general, industrial, and regional agreements, collective agreement within the limits of budget financing. CMU resolutions define tariff scale for employees of budget sphere (e.g. #1298).

Budget entity prepares its budget plan (koshtorys), which is the main plan document of its activity that sets amounts of revenues and assigns expenditures defined for respective budget period. Koshtorys has two parts (general fund and special fund, which reflects financing of special targets). Expenditures are scheduled using the standard economic classification (e.g. wage payments, payroll accounting, payment for goods, services, creation of state reserves, expenditures on fixed assets, transfers made to population, etc). Budget forms of the budget entities need to be approved by Ministry of Finance.

Budget entity can undertake budget responsibilities and execute expenditures only within the limits of budget financing (Art. 51). CMU establishes some limits for budget entities concerning expenditures on buying equipment and other devices (e.g. resolution #332 cars, furniture, PCs etc). Revenues of the budget entities include two parts:

- 1) Own revenues<sup>4</sup> that are reflected at the special fund of the budget;

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<sup>4</sup> The list of allowable revenues is approved by CMU (#659)



2) Financing from the state and/or local budget that is provided on a program basis.

Budget entity has no right to borrow or provide loans at the expense of budget funds unless other provisions are specified additionally by law on State budget (Art. 21).

Key spending units approve budget plans and reports of the spending units of a lower level (The order of compilation, consideration, and approval of budgets of budget entities is defined by the Resolution of CMU #228). State Treasury defines unified requirements for financial reporting of establishments and entities that receive funds from the state or local budget (e.g. Order of State Treasury #17). Accounting standards of the budget entities are defined by the order of Treasury and Ministry of Finance # 114<sup>5</sup>.

According to Budget Code of Ukraine (Art. 87), *state budget finances* the following establishments:

- Establishments of the legislative power (VR), executive power (16 ministries, committees, bodies with special status), the President of Ukraine, judicial power (courts), international activity, establishments that conduct fundamental and applied research of nationwide importance for fostering scientific/technical progress;
- Educational establishments (general secondary education specialized schools, secondary social rehabilitation schools, vocational educational establishments, high educational establishments, out-school establishments, etc);
- Health care (establishments that provide primary medical and sanitary aid, out-patient and in-patient aid, anti-epidemic activities, sanatorium-and-resort aid clinics of research-and-development institutes; specialized hospitals, centers, leprosoria; some specialized dental clinics; sanitary/epidemiological, disinfecting stations);
- Culture and art (museums and exhibitions of nationwide importance, national parks, national and State libraries; organization on international cultural ties, national theatres and philharmonic societies, national and State musical collectives and companies and other non-for-profit entities of culture and art which have the status of national organizations; programs of development of cinematography; State archives; physical training and sport: main national teams; Invasport Center (center for invalids));
- State Road Fund (the Law of Ukraine "On Sources of Finance of State Road Industry of Ukraine"), Ukrainian State Innovation Company (Decree of CMU #979), Fund of Ukraine for Social Protection of Disabled, Insurance Fund of Aviation Safety, State Fund for Favoring Construction of Housing for Young People, Reserved Fund, other establishments that take part in programs of nationwide importance exclusively.

According to Article 88 of Budget Code *local budgets finance* the following units:

Local self-governance bodies of towns, villages, settlements; education (pre-school education; general secondary education (schools with kindergartens); primary medical and sanitary aid, out-patient and in-patient aid (district hospitals, ambulatory centers, first-aid and obstetrics centers and first-aid stations); and palaces of culture, clubs, and libraries in towns, villages, and settlements.

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<sup>5</sup> additionally, there are instructions "On the order of writing off stocks of materials and capital equipment from the balance of budget entities", order "On accounting rules of centralized supply of stocks of materials and capital equipment", order "On correspondence of sub-accounts for reflecting economic operations of budget entities"



Data on the number of budget entities financed from state and local budgets is not available.

Unfortunately, there is no table or scheme that would explicitly show or describe the structure of general government or public sector in Ukraine. There is no special register of budget entities. A program classification of the budget expenditures, where key spending units are listed, could be considered as a kind of such a register. However, budget entities are included into the registers described below.

The State Tax Administration (STA) of Ukraine keeps register of non-profit institutions (including the budget ones) and organizations (Order of STA #232). The non-profitability (Order of the STA #355) is mainly defined on the basis of the Law "On Enterprise Profit Tax".

That implies that STA has a register of non-profit entities. The following entities are listed in the of State register of scientific institutions that receive support from the State: the bodies of state government, the entities and organizations created by bodies of state government and financed from respective budget, the bodies of local self-government, entities and organizations created by bodies of local self-government and financed from respective budget, and Scientific research, high education establishments. These entities have special codes assigned by local body of state service.

The Integrated state register of enterprisers and organizations of Ukraine has been established by the Decree of CMU #118 and is maintained by Derzhkomstat.

The procedure of *registration* in this register includes four steps:

- 1.organization submits registration form and notarized normative documents (resolution on creation of the subject and its Statute). While filling the registration form, the entity should indicate the source of its finance (e.g. budget), their subordination, and mention whether they are budget entities.
2. registration form is checked in the body of state statistics for its completeness, its compliance with normative and statute documents.
- 3.information on organization is included into the State Register
4. within 5 days after the data is included into the State Register, the body of State Register submits information on registration to a respective body of State Tax Administration.

When entity is registered, it gets identification number and codes of classification indication. The code itself does not contain the information that enables somebody to identify whether an entity is a budget one or not. However, there is an addition to the code called "feature". "Feature" is assigned basing on the registration form. This kind of code was updated and used for internal purposed. However, starting from July 2003, the form that should be filled for the registration is changed and the article "The form of financing" is eliminated.

### **1.3. Organizational forms of extra-budgetary institutions**

According to IMF definition, the term " extra-budgetary fund " generally refers to government transactions that are not included into the annual budget presentation. These transactions might not be a subject of the same scrutiny or accounting



standards as the annual budget. In Ukraine, four social insurance funds fit this definition.

### **I. Pension Fund**

Pension Fund in Ukraine was firstly created according to the resolution of the CMU #39 in 1992. A new provision of CMU #345 on the Pension Fund was approved in 1994. The most recent provision was approved by the Decree of the President #121/2001.

Pension Fund is the central executive body that conducts financial management (Art. 1) and is accountable to CMU. It is a legal entity with its own balance and accounts in banking institutions.

Employment limits for Pension Fund are established by the Resolution of CMU (# 403), currently, they include 165 employees for the central body (including 4 deputies of the Head), and 16 112 employees for all subordinated local units.

Pension Fund participates in the formation and implementation of the state policy in the sphere of pension and social insurance (Art. 3). Major tasks of Pension Fund include collection and accumulation of cash for pension insurance, full and timely financing of pension and other social payments that are made at the expense of the Fund.

Pension Fund plays a significant role in the economy. In 2003, its revenues and expenditures are planned in the amount of UAH 25<sup>6</sup> bn constituting 37.6% of revenues and 36.5% of expenditures of the consolidated budget .

The major sources of revenues are the following:

- Total own funds – 85%, including contributions of employers and organizations – 75%, contributions of physical persons – 5%;
- Transfers from the state budget – 7%;
- Transfers from other funds of compulsory state social insurance – 1%
- Residual funds at the beginning of the year - 6 %.

Major expenditures include:

- Payment of pensions, including old-age pensions, disability pensions (including disability not connected with work, childhood disability), time-of-service pensions, survivor pensions (except for cases foreseen by the legislation for insurance against industrial accidents) – 90% of budget,
- Assistance for the funeral of pensioners – 1%;
- Delivery of pensions – 1%;
- Administrative expenditures – 2%;
- Advanced financing of pension payment, covering short-term cash gaps, indexation of pensions and aid – 6%.

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<sup>6</sup> The amount of revenues in the year 2002 totaled UAH 22 bn including own revenues in the amount of UAH 19 bn (or 112.9% of the plan), which exceeds the previous year amount by UAH 3 bn.





In spite of continuous restructuring and writing offs, at the end of 2002, payment arrears to Pension fund constituted about UAH 718 m (including 638 m of insurance contributions).

Planning procedure in Pension Fund includes the following steps: The directorate prepares a draft budget for the next year (koshtorys) and submits it to CMU for approval (Art. 12 of the Law #121/2001). The Head of Pension Fund approves the budgets and the staff list of main local bodies of Pension Fund basing on the consolidated budget of the Pension Fund.

Quarterly and annual reports are signed by the Head and the chief accountant of the respective body of the Pension Fund (Resolution of the Pension Fund #11-4).

Documents of Pension Fund (including its reports) are not fully available to the public; only general figures on budget execution and the amount of arrears are published. Planned budget is not published, but it is obtainable from the legislative database. A general report on expenditures and revenues of Pension Fund is available on the website of the Ministry of Labor and Social policy, and in its specific publication "Compulsory state social insurance and pension insurance in numbers and facts". The Accounting Chamber presents analysis of the activity of the Pension Fund on its web site.

## **II. The Fund of Compulsory State Social Insurance Against Unemployment**

The Fund was established in 2001 (the Law of Ukraine, #1533-III) as a non-profitable legal entity.

It is supervised by Supervisory Board (Art. 13) that consists of 15 persons including representatives of the central executive bodies appointed by CMU, representatives of insured persons (appointed by labor unions), and employers (appointed by unions of employers). State supervision is conducted by the Ministry of Labor and Social Policy.

The employment limit of executive employment service in the Fund constitutes 14600 people (the Resolution of the Fund # 27).

The Fund has been created to manage insurance against unemployment, collect and accumulate funds, provide control over the use of the funds, pay unemployment benefits and provide social services (Art. 8.1). It has its own budget.

For 2003, budget of the Fund is planned in the amount of UAH 2 bn, hence constituting 3.3% of revenues and 3.2 % of expenditures of the consolidated budget.

Revenues of the Fund come mainly from the following sources:

- Total own funds – 74%, including contributions of employers and organizations – 60%, contributions of physical persons – 15%;
- Transfers from the state budget – 2%;
- Residual funds at the beginning of the year - 23%.

Major expenditures include:

- Welfare payments and provision of social services – 71% (including unemployment benefit – 55%; vocation, further training and retraining of unemployed - 5%; subsidies to employers for creation of jobs – 4%; information and consultation services related to employment – 3%; welfare assistance to unemployed and member



of their families and for funeral of the unemployed – 3%; organization of public works – 1%);

- Development consultation system for unemployed – 2.7%;
- Transfers to the Pension Fund – 4.1%;
- Administrative expenditures – 9%;
- Reserves – 5%.

As of January 2003 there were no arrears on social benefits. The number of entities registered as payers of insurance contributions to the Fund constituted 986756, however, only 77.5% of them was actually making contributions. In 2002, Fund provided services to 2.8 m unemployed persons. Unemployment benefits were received by 1.7 m people. One-time aid was received by 0.039 m people. Active labor market policy covered over 1.3 m people. About 0.8 m of people filled the proposed vacancies. Professional training was provided to 0.16 m people. About 0.34 m people participated in public works. Information and consultation services were supplied to 2.4 m people.

Fund's planning includes defining major articles of revenues and expenditures after the state budget for the next year is approved and the rates of social contributions are set up. The Executive Directorate of the Fund prepares the draft budget of the Fund for the next year and submits it to the Council of the Fund (Art. 12). The budget of the Fund has to be approved by the absolute majority of the Council provided 2/3 of its members being present (Art. 10-11). Reports are presented to the Supervisory Board (Art. 13.3).

Executive Directorate of the Fund also prepares the report on budget execution of the Fund and submits it to the Council of the Fund (Art. 12) for its consideration. The Council of the Fund approves the report by absolute majority provided 2/3 of the members are present (Art. 11).

Public access to documents and reports of the Fund is limited. Balance sheet is not published, however totals are available from the official publications (e.g. "Uryadovyi Kurier"). More detailed reports on expenditures and revenues from the previous periods of time are available on the website of the Ministry of Labor and Social Policy, and in its specific publication "Obligatory state social insurance and pension insurance in numbers and facts".

### **III. The Fund of Compulsory State Social Insurance Against Temporal Working Disability and Expenses Associated with Birth and Funeral**

This Fund was established in 2001. It is a legal entity with independent balance. (Art. 1.4 of the Resolution of the Council of the Fund #25). The Fund is a non-profit organization. (Law #2240-III)

It has a Supervisory Board (Nagliadova Rada) that includes 15 persons (representatives of the state which are assigned by CMU, and insured persons and employers which are assigned independently). State supervision is conducted by the Ministry of Labor and Social Policy. The number of employees of the Fund is not disclosed to public.

Fund was established to manage the compulsory state social insurance against temporal working disability and the expenses associated with birth and funeral, including accumulation and collection of insurance contributions and other funds for



financing welfare and social services, provision of these services, and control over the use of the funds (Art. 9).

Fund's activity is financed from an independent budget that in 2003 is planned in the amount of UAH 2.7 bn. Revenues and expenditures of the Fund's budget constitute 4% and 3.95% of the consolidated budget revenues and expenditures respectively.

The major sources of budget revenues are:

- Insurance contributions – 79%, including insurance contributions made by employers and organizations and insurance contributions made by employees;
- Residual funds at the beginning of the year – 11%.

Major expenditures include:

- Assistance for temporal working disability (including sick-child-care assistance) – 38%;
- Assistance for pregnancy, childbirth – 10%;
- Assistance for childcare – 18%;
- Reserves – 3%;
- Financing health-improving actions – 25%;
- Administrative expenditures – 4%.

The vouchers for sanatorium-and-spa treatment were provided to 244,400 insured persons and their family members, 25,000 employees received vouchers for treatment at rehabilitation departments of sanatoriums, 180,000 employees – for treatment in sanatorium. In 2002, there were no social benefit arrears.

Procedure of planning (Art. 13 Law #2240-III) includes developing a draft budget after the state budget for the next year and the rates of social contributions are approved. The Executive Directorate of the Fund prepares the draft budget and submits it to the Council of the Fund (Art. 13). Fund's budget has to be approved by the Council (Art. 12) by absolute majority in the presence of at least 2/3 of its members (Art. 10). Reports are also presented to the Supervisory Board (Art. 15) that can provide recommendations.

Executive Directorate of the Fund prepares the report on annual budget execution of the Fund and submits it for consideration to the Council of the Fund (Art. 13) and also presents it to the Supervisory Board (Art. 15). The Supervisory Board can make arrangements for auditing. The Council of the Fund approves the report by absolute majority provided 2/3 of the members are present at the meeting (Art. 10).

The Fund publishes a rather detailed budget plan for the next year, and a report on its budget execution in "Uryadovyi Kurier". Detailed report on expenditures and revenues for the previous time period is also available on the website of the Ministry of Labor and Social Policy, and in its specific publication "Obligatory state social insurance and pension insurance in numbers and facts". The availability of documents is limited, for example, the Statute of the Fund is available for users of the legislative database, however, it is not provided upon request.



#### **IV. The Fund Of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that caused the loss of working ability**

This Fund was established in 2001 by the Law #1105-XIV as a legal non-profitable entity. The Supervisory Board is empowered to supervise its activities (Art. 26) and consists of 15 persons (specially assigned representatives of the central executive bodies, and insured persons and employers that are assigned independently). Ministry of Finance and Ministry of Labor and Social Policy are authorized to conduct state supervision of the Fund. Employment data is not available.

The Fund has been created to coordinate insurance activity, provide social services and make insurance payments related to the sphere of its activity, which is defined by Art.21. The Fund takes measures to prevent accidents, remove threats to the health of employees caused by working environment.

Activity of the Fund is financed from an independent budget. In 2003, revenues are planned in the amount of UAH 1.38 bn and expenditures – UAH 1.55 bn respectively, thus constituting 2% of the consolidated budget revenues and 2.2% of consolidated budget expenditures.

The revenue part of the budget is formed from the following sources:

- Insurance contributions of employers – 91%;
- Reserved funds – 1.4%;
- Residual of funds at the beginning of the year – 7.6%.

Major expenditures are the following:

- Reimbursement of losses caused by injury or death of employee – 85.6%, including disability pensions as a consequence of occupational accident or occupational disease, assistance for the temporal working disability due to occupational accident or occupational disease, survivor pensions, if the death of a survivor is a consequence of occupational accident or occupational disease, assistance for the funeral of individuals who died from occupational accident or occupational disease;
- Actions for preventing accidents and occupational diseases – 4%;
- Medical, professional, and social rehabilitation of injured persons – 3%;
- Administrative expenses – 5%;
- Reserved funds – 1.3%.

As for 01.01.03, the Fund had no arrears in provision of insurance benefits. In 2002, 300114 victims of occupational accidents received social services and insurance. The Fund also signed more than 400 agreements on implementation of different programs (e.g. program of organization and development of means of personal protection, improvement of working conditions and working safety of employees).

The planning procedure includes development of a draft budget after the state budget for the next year and the rates of social contributions are approved (Art. 13). Planning procedure takes into account dynamics of planned parameters in the previous period of time, and it starts in the second quarter of the year next to the planned one. In November, preliminary numbers are defined at the meeting of the Council of the Fund. Fund's budget is approved by the Council of the Fund by an absolute majority (Art. 17) provided more than 2/3 of actual members are present at the meeting.



Directorate of the Fund prepares and the Council approves the report on the execution of the Fund's annual budget (Art. 17.7) by a simple majority in the presence of more than 2/3 of its members. Report is presented to the Supervisory Board (Art. 26).

The report for 2002 was published in the official periodicals: "Uryadovyi Kurier" and "Holos Ukrayiny". More detailed reports on expenditures and revenues from the previous period of time are also available on the website of Ministry of Labor and Social Policy, and in its specific publication "Obligatory state social insurance and pension insurance in numbers and facts". Access to documents that regulate activity of the Fund is limited, e.g. the Statute of the Fund, its budget plan for the next year, is not available.

#### **1.4. The rules of commercial units' management by the general government**

Currently, management of commercial units with government participation is regulated by the Decree of Cabinet of Ministers of Ukraine "On Management of the State Assets". The definition of the state enterprises is given in the Law "On Enterprises in Ukraine". This Law defines the state enterprises as the ones created on the basis of state property. Ukrainian legislation does not provide formal criteria for considering enterprises with mixed ownership as a part of state sector.

The above mentioned Decree and the Law soon will be substituted by the article 141 from a newly adopted Commercial Code, which starts acting in 2004. Chapter 2 of the Commercial Code is entitled "Main Directions of the Participation of State and Local Governments in the Sphere of Economic Activity". Article 22 ("Specifics of Commercial Units Management in the State Sector") gives a more precise definition of the state sector compatible with OECD standards: the enterprise is considered to belong to the state sector if it is in state property or if the state controls more than 50% of its stocks or if the state has enough votes to have the final say in the decision-making of the enterprise.

In 2000, 32.6% of capital assets were in state property, and 21.9% - in communal ownership.

Rights for managing state enterprises and state shares in closed and open joint stock companies were dispersed across the different ministries. This resulted in miscoordination and a lack of unified approach to management of commercial units. Recently, President of Ukraine issued an Order # 1-1/72 which requires concentration of state management rights in the hands of the State Property Fund of Ukraine. This step was intended to introduce systematic approach to management of state property. State Property Fund is expected to grant the rights to manage state enterprises to the agents of its choice.

Ukraine lacks legislation on management of commercial units by the state. The situation is expected to be improved after the adoption of the Law "On Management of the Objects in Public Ownership", which now exists as a draft.

There is no apparent limitation of the government involvement in private sector, though diminishing of the size of state sector is considered as one of the targets of economic policy. President of Ukraine mentioned in its address to Verkhovna Rada that in the next decade state sector should not exceed 8-10% of Ukrainian economy. However, indicators of the size of state sector were not specified.



Currently, government uses a case-by-case approach to decide on its participation in the private sector. Sometimes, it buys stocks in the private companies. For instance, in 1999 Cabinet of Ministers of Ukraine approved proposal of the State Committee on Communications and Informatization to buy out stocks of "UTEL"(telecommunication company) from a private shareholder (Order of CMU, # 617-p, 1999).

The policy of government with respect to dividends from state assets is described in the Decree of the State Property Fund of Ukraine (#1262, 2000) "On the concept of corporate and dividend policies of the state" describes. This Decree sets the rules for incorporation dividends from state assets into the budget planning, and for determination of dividends taking into account investment needs of the enterprises. Currently, amount of dividends received from state assets is insignificant.

### **1.5. Central Bank status and its independence guarantees**

National Bank of Ukraine (NBU) is a central bank of Ukraine, special body of central public administration. Its legal status, objectives, functions, responsibilities and basic principles of organization are determined by Constitution of Ukraine, the Law "On the National Bank of Ukraine" and other Ukrainian Laws.

The Constitution of Ukraine defines ensuring stability of national currency as the main function of the NBU. In addition, according to the Law on NBU, NBU should also promote stability of banking sector, and price stability in Ukraine. Besides, NBU has several other functions, namely

1. Monopoly right for money emission in Ukraine,
2. Implementation of monetary policy including determination of its main instruments,
3. Control and supervision of banking system in Ukraine.

The independence of NBU from legislative and executive branches of power is determined by Article 53 of the Law on NBU, which prohibits interference of any executive and legislative bodies in the activity of the National Bank unless it is explicitly determined by the Law on NBU (article 51 specifies the cases in which NBU is accountable to the Verkhovna Rada and President. For example, a half of members of NBU council is appointed by the President and another half is appointed by the Parliament. Moreover Article 52 obliges NBU to make consultations with the government as for implementation of monetary policy). Direct credits by the NBU to the government for financing central budget deficit are prohibited (Art.54, the Law "On NBU" and Art.15 of the Budget Code).

However, empirical evidence of the last few years suggests that from time to time the government makes attempts to involve NBU in quasi-fiscal operations. Specifically, in summer 2002, a long-term refinancing scheme was introduced. According to that scheme, NBU can provide long-term (up to 3 years) refinancing credits to commercial banks aimed at crediting innovative projects for real sector. Since the refinancing rate of NMU is much lower than market lending rate, such scheme, according to some officials, will reduce interest rates and increase real investment. However, the results could be just the opposite. Since this scheme implies significant money creation and implicit involvement of government in the activity of NBU, it is likely to produce negative expectations of economic agents regarding exchange rate stability, and,



thus, contribute to higher interest rates and lower investment. Such scheme clearly falls under IMF's definition of quasifiscal operations undermining actual independence of NBU, and does not comply with international standards of fiscal transparency.

## **1.6. Division of financial responsibilities between legislative and executive branches**

Division of financial responsibilities between legislative and executive branches is described in Constitution of Ukraine and Budget Code. Constitution of Ukraine (Articles 85 and 116), determines basic responsibilities of the parliament and the government, and Budget Code (Sections 5-8) defines the role of authorities of legislative and executive branches in the process of preparation, passing and execution of state budget. The legislation provides clear framework for the activities of legislative and executive branches as for the budget process.

Cabinet of Ministers, namely Ministry of Finance, is responsible for working out a draft budget, i.e. it proposes the amount of revenues, specifying its sources, and expenditures, accounting for demands of the budgetary units. Besides, the government defines the amount of borrowings to be done in the budget year. The parliament has the authority to verify the propositions of the government and to propose its own provisions as for increase in revenues or expenditures of state budget during the first reading of the Budget Law in the parliament, if sources of such increase are clearly specified. During the second reading, the propositions of the deputies as for the changes in revenues, expenditures or borrowings volume are not considered, and only Budget Committee of the Parliament can present its conclusions regarding the second draft of the Budget Law.

Though Budget Code provides clear description of financial responsibilities between the government and the parliament, in practice, it is sometimes violated which leads to conflicts between these institutions. During the budget process of the year 2003, Budget Committee has violated a legal procedure of the second reading of the Budget Law and proposed its own version of the budget that differed significantly from the government's version with respect to the total amount of revenues and expenditures, as well as for some other issues. This version prepared by Budget Committee was adopted by the Parliament. In order to correct the violation of the law, the government had to submit the second draft of the Budget Law to the Parliament again for reconsideration. Finally, this caused the delay in the adoption of the Budget Law (it was adopted on December 26, while according to the Budget Code it should be done not later than December 1).

Ministry of Finance plays major role in the organization and coordination of budget execution process. Budget Code (Section 9) defines the authorities of the Parliament and the government regarding introduction of the amendments to the current Budget Law. Specifically, if, according to the quarterly budget execution report, revenues of the general fund of the state budget are executed by less than 85% of the planned amount, Verkhovna Rada has the authority to introduce the changes to the budget by cutting expenditures (so-called sequestration). If execution rate is more than 85%, the government has the authority to cut expenditures without intervention of the Parliament.

The government also plays an important role in state debt management: according to Article 15 of Budget Code, Cabinet of Ministers has the right to make borrowings



within the limit set by the Budget Law, choosing the creditor, as well as type and currency of borrowing. Verkhovna Rada is authorized to set the upper limit for the size of state debt for the budget year. In case the government wants to make new borrowings that lead to the exceeding of the limits for state debt, it needs approval of the Parliament.





## **2. GENERAL GOVERNMENT RECORDING AND REPORTING**

### **2.1. Legal rules for accounting system for general government**

There are about five legislative acts that proscribe main principles of accounting system for all organizational units of general government. The overall framework is defined in the Budget Code: Article 56 states that comprehensive, integrated accounting system for all budgetary institutions, as well as extra-budgetary funds, is developed by State Treasury with approval of Ministry of Finance. Also, there is the Law "On financial accounting in Ukraine" that sets main legal rules of accounting for all organizational units in Ukraine. As for accounting system of budgetary institutions, this law is supplemented by the regular order of State Treasury that is released in January of the next to reporting year and specifies in great details all issues concerning annual financial reports of budgetary institutions, such as list of all accounting forms that each budgetary institution should submit, the description of procedure of the submission of annual reports, as well as some other issues.

Thus, unified accounting system of budgetary institutions that has been established in 1999-2000 is rather clear, well defined, consistent with international standards, and operational. There is no significant empirical evidence about violation of this system.

Accounting of organizational units of general government in Ukraine is done on cash basis.

### **2.2. State budget reporting**

The scope of state budget of Ukraine is determined by the Order of Ministry of Finance "On Budget Classification and its Adaptation". This comprehensive document specifies all revenues included into the state budget, and expenditures financed from the state budget. Moreover, the classification of deficit financing items, i.e. external and internal borrowings, privatization receipts, is presented in this document. The division of revenues between central and local budgets is described in Articles 29, 64, 66 and 69 of Budget Code.

At the end of 90's, fiscal management in Ukraine was very unclear: there were a lot of extra-budgetary funds, which revenues and expenditures were not controlled by the government at all. Financial activity of the universities is a good example. Revenues of state universities contain two parts, namely financing that comes from the state (local) budget and own revenues (e.g. tuition fees). While expenditures covered state budget financing are controlled by Ministry of Education and/or Finance, extra-budgetary expenditures fell out of control of state authorities. Existence of a great amount of such funds led to a low transparency of fiscal management in Ukraine. But, starting from 2000, the vast majority of the revenues and expenditures of extra-budgetary funds has been included into the budget as a special fund. While this measure does not prevent budget units to spent their own revenues on financing



necessary tasks, it increases overall fiscal transparency, since both revenues and expenditures of budget units are shown in the budget and transferred through State Treasury account. Such scheme is completely in line with IMF standards of fiscal transparency. At the moment, there remain only 4 extra-budgetary funds, namely Pension Fund and three social security funds.

Ukrainian legislation does not provide legal definitions of public funds and public income: it defines only budget revenues. According to Budget Code, budget revenues include all tax, non-tax, and other revenues collected on a non-repayment basis in compliance with Ukrainian legislation. Constitution of Ukraine (Article 95) states that usage of budget revenues is determined solely by the State Budget Law.

Article 10 envisages functional, economic, administrative and program classifications of budget expenditures. Functional classification currently consists of 10 broad categories (defense, state functions, health, economic activity, social security, public order, culture, communal services, education and environment protection), each of which is divided into sub-categories. Budget expenditures are classified by functions, whose implementation is connected with expenditures. Economic classification of expenditures is based on economic characteristics of transactions involved. Administrative and program classifications of budget expenditures are closely related to each other: in administrative classification expenditures are classified by spending units that are authorized to make these expenditures. Program classification is the list of programs that are financed from budget, and programs are classified according to corresponding spending unit that is responsible for program execution.

Budget classification in Ukraine was set in 1992 by the Order of Ministry of Finance, but then it underwent a lot of changes via introduction of different amendments. At the end of 2001, new Order of Ministry of Finance "On Budget Classification and its Adaptation" has been introduced. It puts budget classification in Ukraine in line with international standards: extra-budgetary funds are included into the budget revenues and expenditures classifications are done in accordance with IMF standards. Different approaches to budget classification before and after 2002 makes the comparison of budgetary information from different years difficult. For example, till 2002 functional classification of the budget expenditures consisted of 25 categories, but starting from 2002 functional classification includes only 10 categories that makes the direct comparison of expenditures on particular item from, let's say, 1997 and 2002 difficult if possible at all.

According to Article 61 of Budget Code, annual report on the State Budget Law execution should be submitted by Cabinet of Ministers to Verkhovna Rada not later than May 1 of the next to reporting year. This report comprises fairly detailed information on financial liabilities of the government, i.e. the status of the state debt. However, the report lacks information on non-financial liabilities of the government. Moreover, the general government balance does not include quasi-fiscal activities of the government, such as subsidized lending, rescue operations etc. The absence of such information does not coincide with OECD and IMF standards of fiscal transparency. Also, when central budget annual report is considered in the Parliament, the government does not present any information on the execution of major budget programs, i.e. the results of the programs or the explanation of the deviations from program's objectives.

There are no legal requirements that reports of other general government units should be presented to the legislature. Pension Fund and social security funds submit their



annual reports to the Cabinet of Ministers and publish them in press. Organizational units that are financed through the state budget should submit their year-end reports to State Treasury and Accounting Chamber.

Article 62 of the Budget Code describes the *procedure of reviewing* annual execution report on central budget by Verkhovna Rada. Within two weeks after government has submitted budget report to the Parliament, Accounting Chamber studies it and makes the conclusions. Then Verkhovna Rada discusses budget report together with the conclusions of the Accounting Chamber on the plenary session, where Finance Minister should represent government. Presentations on budget execution are made by the Head of the Budget Committee of Verkhovna Rada and the Head of Accounting Chamber. Verkhovna Rada can either approve or disapprove the report on state budget execution, issuing corresponding resolution.

If Verkhovna Rada does not approve annual, it may submit its recommendations to other institutions. For example, in July 2002, the parliament passed the Resolution "On Execution of the Law of Ukraine on State Budget of Ukraine 2001". The resolution contained the conclusion that execution of state budget 2001 was unsatisfactory. The parliament charged the General Prosecution Office with requirement to check whether the budgetary activity of the government in 2001 complied with Ukrainian legislation. Besides, according to this resolution, Cabinet of Ministers should implement the steps that will allow to improve budget execution in the future and to punish executive officials, who are responsible for poor budget execution in 2001. Finally, the parliament asked the President to consider dismissal of the members of the government, who were personally responsible for poor budget performance.

This example shows that in case of disapproval of budget report, the parliament doesn't have much power to change the situation (for example to dismiss any minister), but only to make recommendations to other state institutions.

### **2.3. Extra-budgetary institution reporting**

All funds of compulsory state social insurance should conduct accounting, statistical, and financial reporting. The funds are obliged to submit monthly, quarterly, and annual reports to the Treasury according to its standards (Treasury instruction #27). Each year the Treasury issues an order that describes the forms of financial reporting. According to this Order, social funds should make and submit to the Treasury their consolidated annual reports on the budget plan execution using the form # 2д "Report on Execution General Fund of the Budget of Establishment", and the form of financial report #1 "Balance", which is composed according to examples approved by these funds. The forms have not changed significantly during the last several years.

The funds also submit statistical reports to CMU, the Ministry of Labor and Social Policy, and State Statistic Committee. Principle requirements to the reporting are defined in the Law "On State Statistics". The forms of reporting are approved jointly by the State Statistical Committee of Ukraine and the reporting body.

The funds are also obliged to submit the reports to the bodies they are accountable to. In particular, according to the Decree of the President #121/2001, Pension Fund should submit to CMU quarterly and annual reports on its budget performance which include:

- Information on consolidated budget of Pension Fund;



- Report on execution of the budget;
- Report on accrual of Pension Fund contributions and other revenues;
- Report on execution of the budget on regressive calls;
- Explanatory note that reflects particularities of the budget execution.

The Fund on Compulsory State Social Insurance Against Temporary Working Disability conducts reporting according to the Law "On Compulsory Social Insurance against Temporal Working Disability" (part V). The fund submits the report to CMU each year before the 15<sup>th</sup> of March next to the reporting year (Art 6.9). Financial reports of the fund are composed according to the form 6-ΦCC.

The Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease conducts reporting according to the Law "On Compulsory State Social Insurance Against Occupational Accident that caused loss of working ability" (Art 48). Its reports are submitted to the Ministry of Labor and Social Policy before March 1 next to the reporting year. The Executive Directorate of the Fund informs the Council of the Fund on the execution of the budget on a quarterly and annual basis. The report describes Fund's insurance activity, situation with labor protection in the economy, social protection of victims of industrial accident, and the use of insurance funds. The major reporting forms include:

- Management of insurance funds: collection of revenues; execution of expenditures (social payments provided to victims of accident, social services to the victims, organization of preventive actions on labor protection, development and maintenance of material-and-technical base, maintenance of the Executive Directorate of the Fund and its working bodies);
- Report on labor protection: (info on working conditions, privileges and compensations for work in unhealthy conditions, report on occupational traumatism, report on state of labor safety system), (state of technical safety, providing personal protection devices)).

The Fund of Compulsory State Social Insurance Against Unemployment provides the reports on:

- Budget execution;
- Receivables;
- Financing of paid services.

According to the instruction of the Fund #16, the reports are to be made according to a special form and submitted quarterly to the active Directorate of the Fund. The reports on its activity should also be submitted to CMU according to the Law "On Compulsory State Social Insurance Against Unemployment" (Art. 34.2).

The accounting standards are defined by the instructions on accounting standards approved by each fund jointly with the Ministry of Finance, that are in general based on the accounting standards of Ukraine.

All social funds present their budgets for the next year to executive bodies they are subordinated to. The forms of budgets for the next year are rather detailed and similar to the reports on budget execution and reflect the targets by category and separately by region. Pension Fund conducts monthly planning, while other funds limit planning activities to setting annual targets.



The State Control and Auditing Service of Ukraine is authorized to audit extra-budgetary funds (internal control). The Accounting Chamber conducts audit of the reports of the Pension Fund and presents a detailed audit report on its web-site. The Supervisory Boards of the Funds can arrange audit additionally to the scheduled one at the expense of the fund, if it finds it necessary.

The reports on the activities of the Social Insurance Funds are published at different time in spring in such periodicals as "Uryadovyi Kurier", "Holos Ukrainy". The old data is also available on the web-site of the Ministry of Labor and Social Policy. However, the information is limited in terms of details. While the Fund on Temporal Working Disability and Pension Fund publish more detailed reports and present summary of the report on budget execution, the Fund on Unemployment presents a few general numbers.

## 2.4. General government reporting

### *Monthly Reports*

According to Article 59 of Budget Code, State Treasury of Ukraine submits monthly reports on the execution of central budget to Verkhovna Rada, Cabinet of Ministers, Accounting Chamber and Ministry of Finance not later than 15<sup>th</sup> of the next to reporting month. Besides, not later than 25<sup>th</sup> of the next month, State Treasury releases to the same institutions information on the execution of protected expenditure items of the budget and on the use of the Reserve Fund. However, comprehensive monthly reports on budget execution are made available around 25-28<sup>th</sup> of the next to reporting month.

Monthly Treasury Report is a comparative table that contains information on annual plan, changes to annual plan and executed amount for the reporting period. All numbers are in gross terms on the cumulative basis, so there is no separate monthly data, except of January. Besides, information is provided on the amount of revenues and expenditures of general fund of central budget planned for the reporting period. This allows calculating the execution rate for different items (actual number divided by planned number for this period). Treasury Report contains the following information:

- Execution of revenue items of the central, local and consolidated budgets;
- Execution of expenditure items of the central, local and consolidated budgets (economic and functional classifications are presented, as well as classification of expenditures by spending units – only for the central budget);
- Central budget deficit financing items, classified by type of borrowings and creditors. Borrowings information is presented in great details: borrowings are divided into internal (includes privatization receipts) and external with further classification into short, medium and long-term ones.

Full Treasury Report is available on the web site of Budget Committee of the Parliament. Besides, express-information on budget execution is disclosed to mass media. This information includes collection of revenues of central budget for the reporting period, executed expenditures, execution rates of revenues and expenditures of the general fund of central budget for the reporting period, and the amount of deficit (surplus) of central and consolidated budgets. At the same time, there is no practice to submit any explanatory notes if there is significant divergence



between the actual and planned values. For example, while in 2002, there were underexecution of the central budget revenues (execution rate revenues of general fund was fluctuating around 92%) and expenditures (execution rate was 83-85%), the government didn't present any official explanation of such deviations.

In general, monthly Treasury Reports on budget execution are in line with OECD best practices as for the terms of their release and included information, specifically, presentation of in-year adjustments to original plan, classification of expenditures and information on borrowing activity. However, there is no information available on the amount of revenue and expenditure executed in each month, as well as no any commentary is provided in case there is a divergence between actual and forecasted values.

#### *Mid-Year Reports*

In Ukraine, there is no mid-year reports that show progress in budget execution bi-annually. Instead, information on 6 months budget execution is shown in monthly Treasury Report that is released not later than the 15<sup>th</sup> of July. Besides, according to Budget Code (Article 60), State Treasury submits a quarterly report on budget execution not later than the 35<sup>th</sup> day after the end of reporting period. This quarterly report has the same form and includes the same information as monthly report, but since it is released a few weeks later it contains more refined data. Quarterly reports miss some important issues that are proscribed in OECD best practices. First all, there is no updated forecast of budget outcome (budget revenues and expenditures, borrowings and budget deficit). Besides, quarterly reports do not have any information on employment and employee pension obligations, government's financial and non-financial assets.

#### *Year-End Reports*

Article 58 of Budget Code obliges spending units to submit detailed annual reports which include statements of balances, data on execution of revenues and expenditures, and performance data. In addition, the Decree of Cabinet of Ministers "On the Approval of the Order of Submission of Financial Accounting" states that all organizational units that are financed from the budget should submit their year-end reports to State Treasury and Accounting Chamber not later than the 1<sup>st</sup> of March of the next to reporting year. Few other legislative acts specify the structure of these year-end reports for organizational units of general government.

The procedures of annual reporting of extra-budgetary funds, i.e. Pension Fund, social insurance funds against unemployment, industrial accidents and temporary working disability, are described in the laws on these funds. Specifically, these funds should work out and submit their year-end reports to Cabinet of Ministers and publish them in mass media. So, information on extra-budgetary revenues and expenditures is widely available.

Annual budgetary report is submitted by the Cabinet of Ministers to Verkhovna Rada not later than May 1 of the next to reporting year. It is presented in the same form as Budget Law and monthly and quarterly Treasury Reports, and contains the following information:

- Balance sheet of the execution of the State budget of Ukraine;
- Report on the execution of the State budget of Ukraine
- Report on cash flows;



- Information on the execution of protected expenditure items of the State budget of Ukraine;
- Report on budget arrears;
- Report on the use of resources from the Reserve Fund of the Cabinet of Ministers of Ukraine;
- Information on the status of the State debt;
- Report on loans and other transactions that entail the liabilities guaranteed by the government;
- Information on the execution of local budgets;

The annual budgetary report has a clear form, where in separate columns original plan and in-year amendments to revenues, expenditures and borrowings are shown. Therefore it is easy to draw conclusions on the execution of particular items of the budget. There are three classifications of expenditures: economic, functional, and across the spending units.

So, the structure of presentation of the annual budgetary report is quite good and conforms to OECD best practices. However, it lacks some important information. For example, while there is rather comprehensive information on the state debt and contingent liabilities of the government (state guarantees on loans and borrowings), the information on quasi-fiscal operations of the government and state non-financial assets is missing. This means that important part of government fiscal activity is not shown that definitely does not comply with OECD and IMF standards. Also, there is no practice to present any notes that forecast changes in state debt as a consequence of changes in exchange rate.

#### *Long-Term Reports*

In Ukraine, there is no practice to develop long-term reports that assess the long-term sustainability of current government policies. In particular, in terms of budget forecasts there is no research on the impact of demographic changes on government policy in the budgetary sphere. This important issue, which is proscribed in OECD standards, is missing which negatively influences fiscal transparency in Ukraine.

## **2.5. State budget preparation**

Legislation requires that no later than June 1 or the first day of a plenary session of the Verkhovna Rada of Ukraine the government presents to the Parliament a report on budget preparation (Budget Code, Article 33). Then hearings on budget policy for the next budget period take place in Verkhovna Rada, where the report on "Guidelines of Budget Policy for the Next Budget Period" is presented by the Prime Minister or by the Minister of Finance. This document includes the following information about budget of the next year: planned deficit (surplus) of the state budget, proposed limit on the volume of state debt, shares of inter-government transfers and capital expenditures in the total expenditures of state budget, amendments to be introduced into the legislation for purposes of implementation of the State budget policy, list of protected expenditure items etc. After parliamentary hearings, Verkhovna Rada adopts budget resolution on approving or taking into consideration the Guidelines of the Budget Policy for the next budget period.



Article 37 of Budget Code obliges the government to submit the first draft of the Budget Law to the Parliament not later than September 15. This provision is in line with OECD best practices for budget transparency that requires first draft of the budget to be submitted to the parliament not later than 3 months prior to the beginning of the fiscal year in order to allow the parliament to review it properly.

The first draft of the Budget Law should be supplemented by the explanatory note that contains the following information-analytical materials: detailed description of how budget revenues and expenditures are determined, main macroeconomic assumptions for the next fiscal year (projected inflation and exchange rates and rate of growth of GDP), the program of the borrowing policy of the government, the report on the fulfillment of the Budget Resolution, the report on the execution of central and consolidated budget of the preceding year, information on the budget resources for the last two years and the next budget year, information on the debt service in the long run ( 30 years), detailed information on the stock of the government internal and external debt, the list of the current taxes and obligatory payments, accounting for active tax preferences, execution of the current budget and the major risks that influence its execution, the drafts of the state targeted funds. The evidence shows that explanatory note gives a clear picture of the budget draft and generally complies with the standards of OECD and IMF.

The procedure of passing the Budget Law in the parliament is described in details in the Budget Code (Section 7), where the deadlines of passing the law in the first, second and third readings are defined, as well as the authorities of parliament and the government in this process. According to Article 44 of the Budget Code, the Budget Law should be approved by Verkhovna Rada not later than December 1 of the previous year. However in reality, this rule is almost never observed: Budget Law 2003 was approved on December 26, the previous year budget – on December 20 and so on.

Article 46 of Budget Code contains detailed description of the situation when the Budget Law is not passed before the start of the budget year. In this case, the government has the authority to conduct only those expenditures that were planned for the previous year, and were envisaged in the draft law for the next budget year. Monthly budget expenditures shall not exceed 1/12 of the expenditures proscribed in the Budget Law for the previous year. Also, capital expenditures cannot be made until the Budget Law is passed. The plans for revenue execution are set on the basis of the Budget Law for the previous year.

The final release of the Budget Law (available on the web site of the parliament) contains the text of the law and appendices that show revenue, expenditure (by administrative units) and deficit financing items of the central budget, as well as transfers from the central to local budgets. At the same time, there is explanatory note, which has been submitted to the parliament and then changed during the discussions on the Budget Law. This comprehensive document contains information about macroeconomic framework of the budget, tax expenditures, level and composition of public debt, the program of state borrowings of budget deficit financing and extra-budgetary funds, i.e. drafts of their budgets and explanatory notes to them. Also, the projections of overall size of local budgets (their revenues and expenditures), and thus the projected size of the consolidated budget, are presented in the explanatory note.





However, neither Budget Law nor explanatory note disclose information on quasi-fiscal activities of the government, long-term programs and investment projects that are planned by the government. Besides, in the Budget Law there is no information on limits of employment in budgetary sector.

Section 9 (Articles 52-55) of Budget Code is fully devoted to the regulation of making amendments to the Budget Law. Article 52 specifies legal procedure of making amendments: the amendments to the current Budget Law can be proposed if there is discrepancy between actual and planned budget indicators or in case of the changes in the structure of budget expenditures. The amendments should be submitted as a draft law on the amendments to the Budget Law. The changes in the budget may concern any issues, i.e. revenues, expenditures, structure of the expenditures, transfers to local budgets and government borrowings. There are also special procedures for making amendments to the Budget Law in case of overexecution of revenues and underexecution of expenditures (Art. 53 and 54 respectively).

## **2.6. Access to the public finance documents**

The Constitution of Ukraine (Article 95) and the Budget Code (Article 28) state that regular reports on revenues and expenditures of the central budget should be made public. In particular, Budget Code proscribes that the drafts of State Budget Law, the Law "On State Budget of Ukraine" and information on the execution of central and consolidated budgets based on quarterly and annual statements should be published. Specifically, both first and final drafts of the State Budget Law are published in the newspaper "Uryadovyi Kurier". Monthly, quarterly and annual reports on the execution of central and consolidated budgets are available on the website of budget committee of the parliament, while express-information, including most important indicators, is disclosed by government officials to mass media. However, the information on quasi-fiscal activities of the government and its non-financial assets is missing.

Legislative acts on extra-budgetary funds (pension and social insurance funds) specify that their annual reports should be published in press. The budget drafts of these funds are submitted to the parliament together with the first draft of the central budget and are available in explanatory note that supplements budget draft.

Explanatory note, which is added to the budget draft, contains two scenarios, conservative and targeted. These scenarios consist of government forecasts of budget revenues (PIT, VAT, EPT and excise tax revenues, non-tax revenues), budget expenditures (planned expenditures on social security, economic activity, defense and public order, general state functions, environmental protection and public debt servicing), borrowings and privatization receipts. While this explanatory note is not published in media, it is widely available in the parliament and government.

Budget information is presented in a rather convenient way that, in general, consistent with OECD and IMF requirements and allows making comparisons of actual and planned values for different indicators.

To summarize, the adoption of the Budget Code has promoted access to public finance information in Ukraine, thus increasing overall fiscal transparency. Following the requirements of this document, a lot of public finance information is now published. At the same time, the restrictions in access to information still remain (the clear example is quasi-fiscal operations of the government and NBU). Besides, in case particular



information is not published, it is difficult to get it from state officials despite the Law "On State Statistics" guarantees public access to the information. This shows that although accessibility of public finance information has much improved during the last few years, it is still far from being perfect.



## 3. PROCEDURES OF PUBLIC FUNDS MANAGEMENT

### 3.1. Legal principles of the tax system

The general system and principles of taxation are defined in the Law "On the System of Taxation". The law defines major types of taxes in Ukraine and stipulates that taxes and duties not envisaged by this Law should not be paid. Generally, these provisions are observed. For example, the major taxes are set by the Laws of Ukraine "On the System of Taxation", "On Enterprise Profits Tax", "On Value Added Tax", "On Land Payment", etc. The Law of Ukraine "On unified custom tariff" (# 7097-XII from 1992) defines the object of taxation by custom duty, type of the custom duty, accrual and payment of custom duty. The rate of the custom duty is established by the Law "On unified custom tariff of Ukraine" (# 2371-III from 2001). Privileges on customs duties are granted according to the Decree of CMU "On unified custom tariff" and the Law "On unified custom tariff". However, some regulations are set by CMU decrees, e.g. the Decree of CMU "On Local Taxes and Duties", Decree of CMU "On unified custom tariff". In addition, personal income tax is still regulated by CMU Decree and Decree of the President.<sup>7</sup>

All taxes are administered by State Tax Administration (STA).

According to the classification of the state budget, the Law "On the System of Taxation" defines the following taxes and duties as **central**:

- Taxes on incomes, profits (enterprise profit tax (EPT); personal income tax (PIT))
- Duty for special use of natural resources (wood, water, bowels of earth, etc);
- Property tax (paid by owners of transport vehicles);
- Internal taxes on goods and services (value-added tax (VAT); excise duty (Alcohol, transport vehicles, tobacco products, jewelers, fuel, oil products, etc.); license fees for certain kinds of economic activity (license and certificate fees; registration fees for the objects of entrepreneurial activity; fees for producing alcohol, tobacco products; export and import fees; fees for conducting wholesale of alcohol, tobacco products; fees for permission to issue and trade of securities, license for broadcasting; trade patent fee for some kinds of entrepreneurial activity (trade activity, housing services);
- Taxes on conducting international activity (import duty; export duty, consular fees)
- Other taxes (payment for services of registration for emigrating abroad, fines and penalties for the violated tax legislation, duty for development of wine-growing, gardening, and hop-growing, obligatory contributions to the pension fund.

The **local** taxes and duties are the following:

- Tax on advertisement;
- Communal tax;

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<sup>7</sup> The Law "On the Income Tax on the Physical Persons" was adopted in May 2003, and will become active from January 2004.



- Duty for parking;
- Market duty;
- Duty for apartment authorization paper;
- Resort duty;
- Duty for participation in horse-racing in hippodrome;
- Duty for wining in horse-racing in hippodrome;
- Duty for participating in the totalizator in the hippodrome, duty for the right to use local symbols;
- Duty for the right to conduct telephotography and filming;
- Duty for the right to conduct local auctions, lotteries;
- Duty for transit of vehicles that are heading abroad through the territories of border-adjacent regions;
- Duty for the issue of permission to locate objects of trade and services;
- Duty from dog-keepers.

Rates, the mechanisms of administration, and payment procedure of local taxes and duties are set by local councils according to the list and within the limits defined by the Decree of CMU "On Local Taxes and Duties". Local councils also have a right to grant privileges for taxes and duties within the part paid to their budgets, including personal income tax (Art 65 of Budget Code), tax on owners of transport vehicles, handicraft tax, fixed agricultural tax, enterprise profit tax payable by communally owned enterprises; duties for special use of natural resources of local significance

According to the budget classification, in addition to taxes there are also such burdens as:

- administrative fees (e.g. state duty, customs duty, unified charge administered at stations of pass through state border of Ukraine);
- fines and penalties;
- fees for environmental pollution;
- user fees (for use of broadcasting air, services related to protection of rights for intellectual property, harbor dues);
- social contributions to social insurance funds.

Documents that regulate taxes and instructions of STA are easily accessible from legislative databases (most popular are 'Liga', 'Zakonodavstvo'), VR and STA website. They are also published in numerous official editions and specific accounting journals. STA also conducts explanatory work with taxpayers.

Presently, tax legislation has several drawbacks. First, tax laws and regulations are not completely clear and understandable. For example, the Decree of CMU "On personal income tax" includes general provisions on taxable income, which are not sufficiently detailed and uneasy to understand. To resolve the situation, STA issued the tax instruction that incorporates all legislative provisions and their interpretation.

Second, numerous legislative documents that regulate tax issues and legislative provisions are frequently changed.



Third, there are some loop-holes in the legislation related to technical details. Poor provisions concerning transfer pricing that result in either over- or underestimation of the transactions is one of the examples. Finally, some administrative procedures are not completely clear. For example, the procedure of promissory notes for importers often results in tax arrears because of its difficult administration process established by the Law and, hence, limited ability of tax administration to enforce payments.

There are problems with the execution of both tax-payers' obligations and rights.

*Taxpayers' obligations* on submission to STA the accurate and reliable information, full and timely payments to budgets are not fully executed. High tax rates and complicated tax administration rules result in a high level of tax evasion (according to the estimates of the Ministry of Economy and European Integration, shadow economy in Ukraine amounts to 42.3% of GDP). There are also big tax arrears. The amount of tax arrears constituted UAH 14.7 b (or 32% of tax revenues of consolidated budget 2002) as of 01.01.03. The biggest part of the tax arrears has been accumulated in the fuel-and-energy sector<sup>8</sup>. STA inspections have discovered unpaid taxes in the amount of UAH 4.9 bn.

*Taxpayers' rights* are clearly stated in the laws on tax collection (concerning tax privileges and tax credit) and the Law "On the System of Taxation of Ukraine", the Law "On the order of tax payments to budgets and state targeted funds" (#2181-III as of 2000) that defines the order of making decisions related to tax concessions, procedure of appealing against the actions of collecting bodies, and the order of tax payments. The mechanism of administration and order of payment of local taxes and duties are defined by the documents issued by bodies of local government. Tax legislation states that taxpayer has a right to submit documents that confirm taxpayer's right for a privilege, receive and examine the acts of STA inspections, and contest the decision and actions of STA officials as it is established by laws. *However, taxpayers' rights are not fully observed.* For example, arrears with respects to VAT constituted UAH 7.5 bn as of 01.01.03 (approximately 50% of VAT revenues planned for 2003).

The upcoming tax reform is expected to reduce tax rates, make tax legislation more understandable, and eliminate the loop-holes.

Presently, the rates of major taxes are the following:

- Enterprise profits tax rate is 30% (starting from 01.01.04 25%).
- Simplified system of taxation for small enterprises:

Legal entity whose annual turnover is less than UAH 1 m and employment does not exceed 50 employees can choose between 2 schemes and pay either 6% of income from sales and full VAT, or 10% and no VAT. Entrepreneurs - physical entities whose gross revenues does not exceed UAH 0.5 m per year and number of employees does not exceed 10 persons, pay a fixed amount set by local authorities in the range UAH 20 - 200 per month. In addition, 50% of this unified tax is paid for each employee.

- Value-added tax rate is 20%; the threshold is 3600 non-taxable minimums for a year (art 2.1 of the VAT law).

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<sup>8</sup> In January-October 2002, more than a half of tax arrears were concentrated in fuel-and-energy sector; and state owned enterprise Naftogaz had the largest tax arrears



– Personal income tax rates and annual brackets are 10% (from UAH 204 to 1020), 15% (from UAH 1020 to UAH 2040), 20% (from UAH 2040 to UAH 12240), 30% (from UAH 12240 to UAH 20400), 40% (from UAH 20400 on). Non-taxable income is UAH 204 (annually). (The new law envisaged the flat tax rate at the level of 13%).

Tax rates for some *excisable* goods are as follows: for alcohol products: from EUR 0.05 to EUR 10 per 1 liter; for oil products: from ECU 1.5 to EUR 40 per 1000 kg; for jewelry 50%; for cigars 10 EUR for 100 pieces; cigarettes 5EUR for 1000 pieces; tobacco for smoking EUR 5 per 1 kg; tobacco for mastication EUR 5 per 1 kg; other produced tobacco and its substitutes EUR 5 per kg; for raw tobacco products: EUR 2 per 100 kg; for transport vehicles: from EUR 0.2 to EUR 3 per 1 cubic centimeter of engine cylinder. There is no threshold.

STA examines timing, reliability, and fulfillment of accrual of taxes and duties payments within the limits of its responsibility. According to the Decree of the President of Ukraine (#886/2000, art 5), STA has a right to inspect the documents related to tax accounting and payment (e.g. accounting books, reports, declarations), verify the information, establish the frequency of inspections, get free info on economic activity, bank accounts, incomes, expenditures from enterprisers, establishments, banks, etc; get reports from customs services on imports. The orders of control over VAT and excise payments are established by the joint decision of central state tax administration and central custom body. STA controls the implementation and accounting of taxes by executive committees of local councils, approves forms of tax reporting, registers taxpayers that are physical persons, maintains and develops unified register of taxpayers that are juridical persons. The tax inspectors are obliged to comply with the Constitution and the laws of Ukraine and observe the rights of taxpayers and their commercial confidentiality.

Control over VAT on imported goods, import duty, export duty, customs duty, and excise on imported goods are conducted by State Custom Service (SCS). The representatives of the social insurance funds also have a right to conduct inspections within the limits of their responsibility; however, they have no right to apply financial sanctions.

STA and SCS are central executive bodies, hence subordinated to CMU. STA bodies must not belong to local state administrations (art 2 of the Decree #760/96). STA and CSC activity has to be consistent with legislative Decrees. Heads of STA and SCS are assigned and dismissed by the President.

STA consists of the central office and tax administrations of the Autonomous Republic of Crimea, oblasts, state tax inspections in regions, cities, districts of cities (bodies of state tax service). Special subdivisions for fight against tax crimes are also belong to the service bodies. Structure of STA is approved CMU. The heads oblast administrations are assigned and dismissed by the President on the proposal of the Head of STA (the Decree of the President, #760/96). Activities of STA are coordinated by the Board, which consists of the Head of STA, deputy heads, heads of structural subdivisions of STA. Structure of the board is approved by CMU.

STA has to conduct its activity in accordance with the legislation. The Law "On the System of Taxation" stipulates equal treatment of all taxpayers as a major guideline. However, legislative provisions are contradictive. For example, special provisions of the Budget Law 2003 concerning non-cash settlements with the budget that are not allowed with some exceptions e.g. for enterprises of the Ministry of Defense (art 51 of



the Budget Law for 2003) violate the principle of equal treatment. Moreover, there are numerous tax privileges stated by laws that imply non-equal treatment of taxpayers basing on sectoral, professional, social group, location basis, etc. (see Part 3.2).

List of privileges<sup>9</sup>, the amount of losses in budget revenues as a consequence of privileges, number of recipients of privileges is presented by STA in its form #13 ПП<sup>10</sup>. However, only the list of privileges is publicly available. STA and the Accounting Chamber of Ukraine can report general numbers of tax privileges by main categories of taxes. The form #13 is submitted together with the Draft Budget Law, supplemented with the explanatory note, which includes the amount of revenues that were not received due to the existing major tax privileges.

### 3.2. Procedures of making tax decisions

Verkhovna Rada of Ukraine *establishes and eliminates taxes* and duties (obligatory payments) to the budgets and state funds as well as provides privileges for centrally collected taxes. Legal procedure of implementing a new tax law includes the following steps. Each draft law submitted to VR within 7-days period has to be handed in to the VR Budget Committee for expert evaluation of its effects on the revenue and/or expenditure sides of budgets and execution of the State Budget Law of Ukraine for current budget period. Regulation of VR defines the submission form of the proposed law to be accompanied by the corresponding explanatory note. Within 2 weeks, unless VR establishes another time limit, Budget Committee has to provide expert decision on the effects of the draft law on budget revenues and/or expenditures. In case the draft law leads to decrease in revenues or raise in expenditures in the current or next budget, it has to be submitted together with the proposals on cutting the expenditures and/or raising additional revenues. Proposals ca not lead to increase in state debt or guarantees set by the State Budget Law. Moreover, if according to the expertise of the VR Budget committee, the draft law affects budget revenues and/or expenditures, it should be sent to the Ministry of Finance within 3 days. Within the next 2 weeks, the Ministry of Finance prepares expert conclusions and proposals concerning the draft law specifying its impact and suitable timing for its implementation, and submits it to the VR Budget Committee. The latter should determine the appropriateness of adopting such a draft law by VR and terms of enactment thereof.

The decision on the approval of the proposed law can be made by VR if 2/3 of actual deputies are present at the meeting, and more than a half of the present deputies votes positively.

The procedure of approving the laws has *three readings*. During the first reading, structure of project law is discussed; the second reading includes voting and discussion of the draft article by article; and the third reading relates to draft editing, and discussion of its relation to the other laws of Ukraine. Laws of Ukraine that affect budget revenues or expenditures have to be officially published before August 15<sup>th</sup> of the year that precedes the enactment year of a new law.

There are no provisions that limit *setting central tax rates* directly. However, the Law "On the System of Taxation" states that one of the guides for defining tax policy is

<sup>9</sup> However, their classification is not fully compatible with international standards.

<sup>10</sup> The form is filled basing on the declarations that are submitted to the state tax administration.



economic validity, namely establishment of taxes and duties should be based on indicators of national economy growth and financial potential taking into account necessity of balanced budget. The Law also stipulates that tax rates cannot be changed during one budget year in case there were no extra-ordinary events.

Local councils have responsibility to set *local taxes and duties* and their rates as well as making decisions to grant privileges for local taxes and duties payments basing on the procedure rules established by the corresponding council. The respective decisions are made by the majority of votes of deputies (the Law #280-97-VR).

The limits of the local tax rates are defined in the Decree of CMU #56-93. The upper bounds are the following:

- Market duty: 20% of minimum wage for physical persons and 3 minimum wages for legal entity;
- Dog-keepers duty: 10% of non-taxable minimum;
- Resort duty: 10% of non-taxable minimum;
- Payment for participating in the horse-racing in hippodrome: 3 non-taxable minimums per one horse participating in race;
- Payment for wining the horse-racing: 6% of the prize;
- Duty from persons that participate in the totalizator at hippodrome: 5% of the payment for participation in the game;
- Advertisement tax: 0.1% of location services for one-time advertisement and 0.5% for prolonged advertisement;
- Duty for the use of local symbolic: 0.1% of the value of produced products for legal entities and 5 non-taxable minimums for physical persons;
- Duty for the right to conduct filming or telephotography: the amount of actual expenses made for this action;
- Duty for the right to conduct local auctions, lotteries: 0.1% of reported value;
- Communal tax: 10% of the annual wage bill;
- Duty for receiving trade permission: 1 non-taxable minimum for one-time trade permission; otherwise, 20 non-taxable minimums;
- Tax on sale of imported goods: 3% of respective revenues;
- Duty for the use of some buildings located in the center of city: for Kyiv, Simferopil, Sevastopil: 2 non-taxable minimum per squared meter; for other settlements and cities: 0.5 non-taxable minimums per meter.

Tax privileges (including tax relieves and tax exemptions) could be granted by making amendments in respective collection law (for state taxes). The amendments are made by VR and signed by President. Local councils have a right to grant privileges within the limits of revenues of their budgets.

Tax privileges can be classified into socially targeted ones; sector privileges; territorial-sector privileges (special economic zones; technological parks <sup>11</sup>; special

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<sup>11</sup> The list of activities of high priority are established by the Presidium of National Academy of Science and central executive body for each technological park.





investment zones); privileges that favor innovation activity; and privileges for avoiding double taxation.

The laws that establish privileges and introduce amendments to the tax collection laws usually contain the goals to be achieved through granting tax privileges.

The goals to be achieved via granting different tax privileges to industries and territories includes the following:

- Increase in employment (#402-XIV art 1, #721-XIV art 2);
- Increase in production (#402-XIV art 1, #721-XIV art 1.2);
- Attracting investments (#535/97-VR, 1559-III art 3, #2211-III intro, etc.);
- Preserving development of R&D, technological and production capacities, implementing new technologies (law on airspace industry, #402-XIV art 1, #721-XIV art 1.2);
- Increase in export potential (#1559-III art 3, 2211-III intro);
- Decrease in production costs (#2211-III intro);
- Regional development, (#721-XIV art 1.2);
- Solving environmental problems (#402-XIV art 1);
- Development of infrastructure (#402-XIV art 1, #721-XIV art 1.2).

Social privileges are granted for the following goals:

- Protecting low-income people;
- Protecting disabled persons;
- Young people protection (e.g. Kyivmiskbud experiment).

PIT and payroll tax privileges could be granted in compliance with the Constitution and legislation on the social protection of some groups of people (single mothers, pensioners, etc.). However, currently there are also occupational privileges, for example, special low PIT rate for coal industry and nuclear power station workers.

In reality, tax privileges are granted in case of a successful lobbying in the parliament (e.g. experiment in metallurgical industry).

Tax relief with respect to central taxes is generally granted by VR. However, local councils are also empowered to grant local privileges within the limits of their budget revenues.

#### *Industry and territory specific tax privileges*

Currently, there are numerous examples of tax privileges. *Agricultural sector* receives a special treatment via special taxation regime (the Law #168/97-VR). Agricultural producers<sup>12</sup> pay VAT to the special account and use these funds for their own production purposes. Sales of some goods that are produced at the own capacities of agricultural producers (milk, meat, cattle, and wool products) are not subject to VAT. Contrary to other industries, in agriculture gross income and expenditures are indexed by the inflation rate, land tax is credited against EPT (in other cases it is deductible). The Law "On the Enterprise Profit Tax" allows a deduction of purchase and fattening of

<sup>12</sup> Share of their gross income from the sale of agricultural products should exceed 50%.



productive cattle, and growing of perennial fruitful plants. There is also a simplified scheme of taxation (Law #320-XIV). Fixed agricultural tax (FAT) is set at the level of 0.5% of the land value. The rate of FAT may be increased if the taxpayers' total tax liability in 1997 exceeds current FAT. Taxpayers of FAT are exempt from such taxes as EPT (except for dividends and withholding tax), land tax, vehicle owners tax, communal tax, levy on geological works financed from the state budget, contributions for compulsory state social insurance, road tax, trading patent fee, levy for the use of natural resources (use of water for agricultural purposes).

In free economic zones and technological parks, the enterprises of the selected industries also enjoy substantial tax privileges. For example, they are exempted from EPT, VAT (exempt or 0% tax rate, usually for 5 years), land tax (usually for 3 years), import and export duties, compulsory state social insurance contributions (#721-XIV, #402-XIV), etc (excise #402-XIV, #721-XIV). Table 3.1 presents information on tax privileges in free economic zones (FEZ) and zones of preferential development (ZPD).

**Table 3.1 EPT privileges in free economic zones and zones of preferential development**

Name	Min investment (\$ 1000)	EPT exemption is granted for years	Tax relief is granted for years	Tax relief %	Tax relief for non-residents %
<i>Special economic zones, including</i>					
Port Krym				33.3	
Interport Kovel				33.3	33.3
Donesk				33.3	33.3
Azov				33.3	33.3
Zakarpattya				33.3	33.3
Slavutich	200	3	4-6	50.0	
Yavoriv	500	5	5-10	50.0	
Kurortopolis Truskavets	500	3	4-6	50.0	
Mykolayiv	500-3000	3	4-6	50.0	
Porto-Franko	1000	3	4-6	50.0	
<i>Zones of preferential development, including</i>					
Crimea	100-500	3	4-6	50.0	
Volyn oblast	250	3	4-6	50.0	
Donetsk oblast <sup>13</sup>	1000	3	4-6	50.0	33.3
Zhytomyrska oblast	200-500	3	4-6	50.0	
Zakarpatska oblast	250	2	3-5	50.0	
Luhanska oblast	1000	3	4-6	50.0	
city Shostka	200-1000	3	4-6	50.0	
Chernihivska oblast	500	3	4-6	50.0	
city Kharkiv	500-3000	3	4-6	50.0	

Source: Legislative documents

Entities covered by a *special regime of investment activity* are exempt from import duty (usually for 5 years, except for excisable goods), VAT (usually for 5 years), EPT, land tax (#1276-XIV). For example, the objects of Kyivmiskbud experiment are exempt from EPT, payroll taxes, VAT.

<sup>13</sup> In addition, dividend tax in Donetsk region ZPD is reduced to 10%.



Armored industry enterprises for the period of 2001-2005 are taxed at 0% rate of VAT, exempt from import duty on inputs, land tax, there are special provisions related to EPT (#2211-III).

Enterprises of airspace industry (with investment of at least US\$ 400 thousands) are exempt till 01.01.09 from import duty, land tax, VAT (#1559-III). Special norm of 20% is set for the third group<sup>14</sup> of capital assets.

Car building industry enterprises are exempt from import duty, land tax, VAT, and have some privileges on EPT payment (e.g. indexation for inflation) till 2008 (#535/97-VR). The profit of car building industry enterprises (with investments of at least USD 150 m) is reduced by the amount transferred for credits redemption granted for implementation of the program established by CMU and amount reinvested in the development of their own production facilities. Moreover, for taxable purposes, the gross expenditures are calculated using a special procedure.

For the period of 2002-2011, the revenues received in the form of targeted extra fees for electric power sold at wholesale market are not included into taxable income. The extra fee is equal to 0.75% of existing tariff. Aforementioned funds are collected in a special account and used for construction of wind electric stations and R&D works in this sphere (The Law, #334/94-VR).

#### *EPT privileges*

In addition, the following objects are exempt from EPT: proportional payment of dividends in case they are paid in the form of shares issued by the enterprise; profit from sales of baby-food products in custom territory; profits from waste-product collections, targeted receipts of out-school establishments, excess of revenues over expenditures from state lotteries activity. Profits received from R&D and restoration works in sphere of protecting cultural heritage are taxed at the rate reduced by 50%. Enterprises founded by organizations of disabled persons are exempt from EPT.

International technical aid provided on the basis of international treaties is not included into gross income.

The following items can be included into gross expenditures of tax-payers: charitable contributions of the enterprises within the limits of 2-5% of taxable profit of previous period; charitable contributions of the enterprises established by the national organizations of victims of Chernobyl catastrophe (within 10% of taxable profit); payment for land that is not used in agriculture by agricultural enterprises; amounts of contributions to additional pensions plans of employees (but not more than 15% of total yearly earning income of the employee); funds transferred for construction of dwelling for military servicemen according to the agreements made before 01.06.97; contributions made by the enterprises to special deposits of their employees within the frames of Kyivmiskbud experiment (within 10% of gross income for the reported period); contributions made by specially empowered banks to special reserve of long-term reserve of insurance funds of pension fund of bank management; value of coal given to specific groups of individuals according to norms defined by CMU; expenses

<sup>14</sup> There are 4 groups of capital assets,  
1<sup>st</sup> group include buildings, constructions, and transmission devices;  
2<sup>nd</sup> group include transport vehicles, spare parts, tools, and equipment;  
3<sup>rd</sup> group include other assets that are not mentioned in the 4<sup>th</sup>, 2<sup>nd</sup> and 1<sup>st</sup> group.  
4<sup>th</sup> group include computers.



related to purchase, installation, and completing construction of a non-finished object that have been bought on the basis of privatization contacts. 20% of insurance reserves of banking and non-banking financial institutions are added to their gross expenditures.

Furthermore, balance profit of a tax-payer is reduced by the amount of his balance losses (indexed) in previous periods. Special rates of taxation are set for profit received from sales of innovation product (50 % out of the effective rate).

Ukrainian-sourced gross income of non-residents, who do not conduct entrepreneurial activity via their permanent establishment, is taxed at the rate of 15%. Revenues of non-residents received from interest/discount on state/local assets sold by non-residents abroad are not taxed. Accelerated depreciation could be used for the third group of capital assets. The tax paid by the objects of technoparks are transferred to the special accounts and then used exclusively for their R&D purposes.

#### *Vehicle owner tax privileges*

Tax exemptions are granted to the enterprises of public traffic in case the tariffs are set by law, and state-financed educational establishments. 50% relief is granted to agricultural enterprises that do not qualify for FAT.

#### *Privileges with respect to the payment for the use of natural resources*

Local governments can grant privileges for land tax and duties for use of wood, water, interiors of the earth resources, and geological survey works, in case they are conducted at the expense of the state budget. Land tax exemptions are given to entities that promote environmental protection, including historical and cultural national parks; forest reserves (excluding hunting); regional landscape parks; botanical gardens; dendrological and zoological parks; memorial parks and gardens; national and scientific research enterprises; agricultural educational establishments.

Moreover, the following entities are not subject to land tax as well: bodies of state and local government; bodies of public prosecutor; budget establishments and organizations (except defense enterprises); some specialized recreation establishments; organizations of disabled persons; non-profit religious and charitable organizations; preserved lands; state testing plants; road lands of public transport; cemetery; national educational, health-care, scientific, physical culture and sport establishments; some establishments and enterprises that develop and produce elements of ammunition and special chemical products; agricultural enterprises located at Chernobyl zone; enterprises that are involved into activity of young gardens, berry-fields, and vineyards; plane-building enterprises defined by law; enterprises and organizations of National Academy of science; ship-building industry enterprises, subjects of free economic zones, technological parks.

#### *VAT Privileges*

The following operations are exempt from VAT: issuing and allocation of securities issued by subjects of enterprise activity, NBU, the Ministry of Finance, local government; operations from providing insurance services envisaged by law; providing state services; payments made from state or local budgets to physical persons; transfer of confiscated property and treasures to state bodies; free transfer of trains by one enterprise of railroad transport to another in the order established by CMU; R&D developments made in expense of the state budget; providing services by libraries that are in state or communal ownership; sales and import of goods for



internal needs of diplomatic establishments, consular establishments, and representative offices of international organizations according to the list established by CMU; privatization of state-owned property or communal property as well as services that are obligatory for privatization process.

Following operations are also not subject to VAT: providing educational services according to the list established by CMU; providing out-of-school commercial services to students by educational establishments; operations from sales or free transfer of equipment, materials to scientific establishments, and establishments of high educational included into the list of state register of scientific organizations; sales of vouchers for children's recreation; services related to keeping children in pre-school establishments, orphans houses; meals at schools and in healthcare establishments; keeping persons in houses of invalids and old peoples' houses; sales of some goods for invalids; feeding and providing night's lodging to homeless people; providing feeding and property to some poor people according to the list established by CMU, free transfer of products (works services) produced by affiliated agricultural, healthcare goods producers of orphans houses, and local centers for servicing lonely old-aged people in case it is made for ensuring their own needs; operations of repair of schools, orphans houses, pre-school establishments, health-care establishments in rural areas; providing employment services; operations related to preparation and undertaking Olympic and Para Olympic games; some archival services; providing charitable aid; providing material aid to some entities.

Sales of baby food products; sales and delivery of periodicals of national producers, school copybooks and textbooks; sales of some drugs; providing religious services and sales of religious-purposed products by religious organizations according to the list established by CMU, burial services; sale or transfer new housing; operations from import of sea products (e.g. fish), city transport in case there is tariff regulation; sales of children festival gifts that are purchased by labor units; some ship building industry inputs (products are taxed at 0% rate); sales of milk and meat by agricultural enterprisers to processing plants (till 2004); import of some inputs of plane-building enterprisers (and operations of sale of products are taxed at 0% rate till 2007) are VAT exempt.

The participants of international treaties and entities of free economic zones, technological parks, zones with special investment regime are exempt from VAT. Some gas and oil products in case they are imported from Russian Federation, Turkmenistan. Chernobyl nuclear station operations conducted at the expense of international technical aid are exempted from VAT for a limited period. VAT from sales of some waste products is collected at a special account and stays at disposal of the respective enterprises.

Zero-rate VAT is set for exported goods; sales of milk and meat by agricultural enterprisers to processing plants (till 2004). Amounts of VAT paid by retail trade enterprisers that are located at customs control territory to their suppliers; operations on supplying transport services on transporting passengers and freight abroad should be reimbursed from the budget according to the order established by CMU.

#### *Excise privileges*

Till 2005, the rate of excise on ethyl alcohol that is used for production purposes is reduced. Sales of automobiles, freight/passenger vehicles and motorcycles produced by Ukrainian enterprises of all types of ownership, are exempt from excise tax until



2007. Imported inputs for production of excisable goods, imported spare parts for transport vehicles production are exempt from excise. For some alcohol products 0% excise rate is set. Excise tax is not paid by the enterprises for the receiving of non-denatured alcohol for production of grape wine materials or stum in case these outputs are sold to enterprises of secondary wine-production.

The following imported goods are **exempt from excise**: sale of cars for disabled persons that are purchased at the expense of social security bodies, as well as cars for special purposes (emergency, police, etc) according to the list established by CMU; confiscated excisable goods, excisable goods either for transit or for exhibition purposes, inputs for the production of excisable goods, spare parts for production of transport vehicles, charitable aid according to the list established by CMU (e.g. emergency aid transport vehicles), some products for their use by intelligence body.

#### *PIT privileges*

The amount of gross taxable income is reduced to 5 non-taxable minimums for the following groups: parents that foster handicapped from birth; Chernobyl victims of III and IV categories; World War veterans; handicapped from birth; political victims; veterans of the war in Afghanistan.

The amount of gross taxable income is reduced to 10 non-taxable minimums for the following groups: Chernobyl victims of I and II categories; disabled veteran of I group.

The gross taxable income of people with dependent child is reduced to 1 non-taxable minimum. Funds transferred to special accounts of participants of Kyivmiskbud experiments are tax exempt, incomes of minors are taxed at 10% rate, tax rates applicable to income of workers at nuclear energy plants are reduced by 50%.

The list of tax revenues losses caused by privileges is available as an annex to the explanatory notes submitted together with the draft budget law. Detailed data is not available for public. Control over the execution of tax legislation is conducted by STA. Tasks and responsibilities of STA is clearly defined by legislation that regulates its (including provisions of laws, CMU resolutions, acts of the President). However, the STA employees sometimes follow verbal instructions, which violate the rights of taxpayers. However, in case the taxpayer submits complaints to the control bodies (petition of appeal), then the term of payment of tax liability to the budget is terminated until the court makes a decision

STA is directed and coordinated by the Cabinet of Ministers. In the past, the STA was under the supervision of the Ministry of Finance of Ukraine. Today, the Ministry of Finance has limited access to the STA information essential for conducting its direct tasks.

### **3.3. Rules concerning public procurement**

The Law of Ukraine "On public procurement of goods, works and services" (N 1490-III, 2000) regulates all purchases of all goods, works and services, which involve public funds, where the amount of the purchases exceeds the sum equivalent to EUR 2,000 for goods and services, and EUR 100,000 for works.

This Law standardizes procurement regulations. Its implementation is achieved through the Order of CMU "On organizational measures concerning the functioning of the system of public procurement" (#1469, 2000).



The Law specifies the cases, when the purchases of goods, works and services are to be conducted through a particular form of public procurement, such as open tendering or asking for quotes. It determines the requirements for the firms that are competing for a contract. The legislation also specifies the details of reports to be submitted to the State Statistical Committee, by the bodies that use public procurement mechanisms.

Public procurement procedure provides exemptions for the contracts related to national defense or purchase of sensitive technologies. Exemptions can be granted by the Cabinet of Ministers of Ukraine.

Organization of public procurement does not exclude other mechanisms. In the first quarter of 2002, 66.3% of funds were spent through the mechanism of asking for price quotes. In contrast to open tendering, it does not require open competition, i.e. the purchaser only provides several price quotations from different sellers and explains why a particular seller has been chosen (sometimes the quote does not explain the quality of the good; maintenance services; quality guarantee). Although public procurement is dominated by asking for quotations, the amount of funds spent through open tendering grows.

The Law "On public procurement of goods, works and services" sets similar regulation for the purchases from the state and local budgets.

In order to participate in tender, potential contractor has to meet certain qualifying criteria. The contractor should have the appropriate license, funds, equipment and workers with experience necessary to fulfill the tender conditions. The contractor has to pay taxes and fees foreseen by Ukrainian legislation, conduct its activities according to its statute, and provide the evidence about conducting similar (not necessarily public) contracts in the past (Article 15, *ibid.*). The participation in tender in be refused, if the contractor is a bankrupt or in the process of bankruptcy, or if the purchaser receives information that the contractor has been convicted of acquisitive crimes, and the sentence is not canceled in an appropriate way (Article 11, *ibid.*).

Article 6 of the Law describes the conditions of the protection of national producers. Provided the tender amount does not exceed for goods – EUR 200,000, for services -- EUR 300,000, for works - EUR 4 m, the purchaser can give a 10% higher preferential price to domestic producers. In case price of the contract exceeds these limits no discrimination is introduced. Prospective foreign contractors can also be required by the conditions of the tender to use domestic inputs. Several organizations (e.g. Association of the blinds) are entitled to the 15% preferential price increase with no restriction in the sum of the contract.

The Decree of CMU "On Adoption of the Rules of Inter-agency Coordination of Public Procurement" (N1312, 2001) describes the conditions when centralization of purchases is required. This decree is mandatory for central government and is advised for execution to the local governments. According to the Decree, if several agencies consider buying the same good for more than EUR 200,000, the Ministry of Economy and European Integration appoints the main purchaser (e.g. the agency with the largest purchasing plans). Then all other purchasers are to sign contracts with the firm which has been selected by the main purchaser, although flexibility is allowed if one of the smaller purchasers is unsatisfied with the choice of the main purchaser.

Ukrainian fiscal system introduces a hierarchy of the public funds disbursements. Thus, the lower rank agencies are to forward their plans of purchases to the agencies of a higher



level. Then, in case of need, the agencies of a higher level organize centralized tenders. Central government bodies, such as Ministries, State committees, Central Election Committee, form tender commissions responsible for centralized purchases.

Even if such centralization is not required by law, local governments can delegate the power to conduct purchases to the oblast centers in order to save on transaction costs and receive lower price quotes.

The Ministry of Economy and European Integration is the main body responsible for supervising the system of public procurement. The detailed procedure and the documents necessary for holding tenders, reporting the results and submitting and accepting complaints concerning tender procedures are defined in the Order of the Ministry of Economy and European Integration (N238, 2002) "On organization of control over the adherence to current legislation on public procurement of works, goods and services".

However, the Law also gives a power of control over the public procurement to the State Control and Auditing Administration, Ministry of Finance and local financial control institutions. The of the State Control and Auditing Service is responsible for financial control, while procedural questions are in the power of Ministry of Economy and European Integration. The latter monitors public procurement mechanism on a regular basis. For example, in the first quarter of 2002, 2,447 enterprises were inspected. In 432 cases a violation of Law on public procurement was found; i.e. purchase of works, goods and services was conducted without recourse to tendering. There were also violations in the form of providing improper documentation and ignoring mandatory procedure of announcement of tenders in the "Herald of public procurement". In case of procedural violations the results of a purchase or a tender can be deemed void, and a new procedure is to be held.

The practice of open tendering is fairly new to Ukrainian government. The amount of public funds spent through open tendering grows continuously; however, not all public agencies follow the legislation closely. In the Letter "On functioning of the system of public tenders in I quarter 2002" (N 19-23/1678-10, 2002) it was mentioned that in the first quarter of 2002, 61 out of the 83 main public funds spenders submitted the statistical public procurement form to the State Committee on Statistics. The legislative framework seems to be in place, which allows further improvements in the public procurement mechanism, however, its implementation, including prevention of corruptive practices, remains high on the agenda.

If the enterprise finds that the tender procedure was not transparent or the legislation was violated, it could complain to the Ministry of Economy and European Integration. Ministry checks the complaint and makes an official decision. Complaints can be granted no satisfaction if there has been no violations, or satisfied, which usually leads to the repetition of tendering process.

Persons responsible for the violations of public procurement procedures can be drawn to the administrative and criminal responsibility depending on the violation's gravity. Violations of public procurement regulation are punished in accordance to general provisions for the mismanagement of public funds.





### 3.4. Rules concerning social benefits

Different Laws of Ukraine and Resolutions of the Cabinet of Ministers establish types of social benefits in Ukraine. The compulsory state social insurance is conducted via extra-budgetary funds, and is described in Part 1.3. Among social benefits that are paid either from the state or local budgets are pension benefits<sup>15</sup>, stipends<sup>16</sup>, different privileges and subsidies. Moreover, the Constitution stipulates that state and communal health protection institutions provide medical care free of charge (Article 49). In Ukraine, health protection is ensured through state funding of the relevant socio-economic, medical and sanitary, and prophylactic programs.

#### **Sources of financing social benefits**

According to the Budget Code, the following social benefits are financed from **the State budget**:

- Stipends at:
  - vocational educational establishments and education-related establishments based on state property;
  - establishments of higher education based on state property;
  - post-graduate educational establishments based on state property;
  - other state educational programs.
- State special pension programs:
  - pensions to military servants;
  - pensions to people fired due to closure of Chernobyl nuclear electric station;
  - early-retirement pensions to people whose health was damaged due to Chernobyl accident;
  - pensions set by different state pension programs (including additional payments and financial support).
- State social support programs (compensations for medicines; prosthesis programs; programs and activities related to social protection of invalids, including reimbursement of losses incurred by citizens; annual lump-sum aid to veterans of World War II; permanent stipends for war participants);
- National programs and activities with respect to children, youth, women, and families; and
- State programs to support construction (reconstruction) of housing for certain categories of citizens.

The following social benefits are funded from **local budgets**:

- Stipends at:

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<sup>15</sup> The Pension fund receives money from the State budget for paying pension benefits to militaries and additional benefits according to different pension programs.

<sup>16</sup> The Resolution of CMU #950 establishes the amount of stipends and the procedure of stipends payments.



- vocational educational establishments owned by the Autonomous Republic of Crimea and implement the state order;
  - educational establishments of higher education of the I, II, III, and IV levels of accreditation owned by the Autonomous Republic of Crimea and communal educational establishments;
  - other state educational programs.
- State social protection and social security programs (aid to individual taking care of invalids of the 1 or 2 groups with mental disorders; targeted social assistance to low-income families; compensation paid to the rehabilitated; additional social assistance to pupils at the educational establishments; children's boarding establishments; training and job-finding for invalids; hospices for aged and handicapped; hospices for handicapped children; pension centers; hospices for adolescents);
- Republic-wide (in the Autonomous Republic of Crimea) and oblast-wide programs and activities related to the state support policy to children, youth, women, families, etc.

### ***Social privileges and subsidies***

The groups of population liable for social privileges and subsidies include:

- veterans of war and labor, veterans of military service, veterans of the internal affairs bodies;
- low-income people;
- citizens that suffered from Chernobyl accident;
- certain occupational groups (military servants, deputies, etc.).

In 2003, the following privileges and subsidies are to be financed at the expense of subventions from the State budget to local budgets:

- electricity and gas payments;
- communication services;
- housing and communal services;
- purchase of liquefied gas, solid and liquid fuel for stoves;
- compensation of transportation costs for certain privileged groups of people, etc.

Privileges and subsidies are covered by organizations (service providers)<sup>17</sup> at the expense of their own funds. Then, these costs are to be compensated from local budgets on the basis of calculations provided by organization.

According to legislation, privileges related to suburban transportation are to be covered by local governments, and subsidies related to inter-city transportation of privileged passengers are to be covered by the State or local governments depending on the subject that has granted these privileges.<sup>18</sup>

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<sup>17</sup> The organizations include state bodies, bodies of local and regional governance, enterprises, institutions and other organizations.

<sup>18</sup> 85% of passengers transported locally do not pay for transportation. There are 16 categories of privileged passengers, although within these categories the number of the privileged is restricted. The government still relies on passenger transportation funded at



However, in practice, refunding of privilege-related losses to providers of services remains a painful question, since they are not totally compensated from local budgets, thus endangering financial situation of the respective enterprises. Some positive development in this respect is associated with the Decree of CMU<sup>19</sup>, which obliges local councils (Radas) to cover travel expenses of local deputies (in line with their right to get free transportation). Previously, transport enterprises bore the costs of free transportation of the deputies, requesting compensation from local governments afterwards.<sup>20</sup> This was a complicated procedure with an uncertain outcome. New rules are meant to decrease the unauthorized use of transport privileges, and protect transport enterprises from losses if compensation was not paid in time.

The amount of social benefits as well as the conditions and procedures of obtaining state assistance are set by the resolutions of the Cabinet of Ministers. In addition, central executive bodies and local administrations have a right to provide extensive social protection services for certain groups of people with low income.

For example, the Resolution of CMU #1156 sets the amount of payments for housing and communal service for people who are eligible for obtaining subsidies. The rules for eligibility for those subsidies are set by the mutual order of different ministries (#379/2819). However, due to insufficient funds for financing these subsidies, some low-income families were not able to use their right to receive state assistance.

According to the estimation of the Ministry of Economy and European Integration, in 2003 in order to compensate all privileges set by the legislative acts State Budget needs UAH 17.3 bn (34% of revenues of the State budget 2003). However, in the adopted State Budget 2003 the actual amount of relevant expenditures is less than UAH 6 bn (12% of revenues of the State budget 2003). Consequently, provision of non-compensated privileges and subsidies becomes a burden for the enterprises that provide services thus making them unprofitable. This pushes enterprises to increase tariffs of their services for non-privileged groups of consumers.

Indexation of social benefits is based on the Law of Ukraine "On the Indexation of Monetary Revenues of the People" (#491-IV). According to the Law, monetary revenues of individuals received in hryvnias on the territory of Ukraine and do not have one-time character, are subject for indexation. They include pension benefits, stipends, wages, benefits paid according to the legislation on the state compulsory social insurance, disability compensations, and compensations of other health damages. The Cabinet of Ministers can set other objects for indexation. The revenues are indexed in the limits of subsistence minimum set for a respective social and demographic group of people.

Indexation of social benefits is conducted only when consumer price index (CPI) exceeds 101. The raise in revenues of the people related to indexation is conducted starting from the first day of the following month at the expense of own funds for non-budgetary entities, and at the expense of state budget funds for budgetary entities.

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the expense of Ukrzaliznytsia. The number of privileged passengers, who are subsidized, reached 70% of total passenger transportation. From 30% to 80% of all passengers do not pay for transportation, depending on the region. Subsidies provided out of central government funds cover only 2.5 trips per month per privileged passenger. (IMU, #3/2002)

<sup>19</sup> Decree of CMU "On rules and conditions of free transportation for the deputies of local councils", N 1738, 16.11.2002.

<sup>20</sup> Decree of CMU "On adoption of rules and conditions of free transportation for the deputies of local councils", N 702, 11.10.1994.



### 3.5. Rules concerning state aid

Currently, paragraph 3 of the Article 1 of the Law "On Enterprises" (#24, 1991) states that enterprises could be provided with subsidies and other privileges if the state considers it to be socially beneficial. This Law does not provide any details on the types of aid and conditions of its granting. As of today, Ukraine has neither a clear and transparent procedure of providing state aid, nor an institution, which controls and monitors the state aid. Ukrainian legislation does not give any definition to the "state aid" and does not have any norms that would ensure the usage of the state aid as of one of the instruments of the governmental policy.

Article 16 of the new Commercial Code, adopted in 2003 (effective since 1.1.04), entitled "State subsidies and other forms of state support" says that the state can grant subsidies and give aid in other forms and lists a number of activities that could be subsidized (e.g. help to the invalids, production of vital medicine, transportation services for socially important freight, etc). State aid could also be given to the agricultural sector when it sells its product to the state. The Code stipulates that that the state aid has to be regulated by additional laws. Article 16 does not give any details on the amount, timing and procedure of the state aid, being general in its character. Currently, Ukraine has only sector-specific laws on aid and lacks a general Law "On State Aid", which is currently being drafted by the Antimonopoly Committee of Ukraine.

In principle, the state can support an enterprise by granting it privileges or direct subsidies proscribed in the legislation and distributed by CMU. However, tax arrears could also be considered as implicit state subsidization.

Specific laws are passed every time the state support is provided to any of the sectors or enterprises. These laws are later on accounted for in preparation of the state budget. An example of sector specific state aid is air-construction industry, where according to the Law "On state support for the air-construction industry in Ukraine" (2660-III, 2001) enterprises which are entitled to customs and tax privileges from 2002 to 2007. Sector-specific support is provided if the sector is determined as a priority one for the state.

Agriculture, among other types of support, receives tax privileges granted by the Law "On stimulation of the agricultural sector for 2001-2004" (2238-III, 2001). In 2001, the volume of tax privileges concerning VAT refund for agricultural sector was about UAH 1,175 bn.

Information on the amount of state aid in the form of subsidies can be found in the Law on State Budget. In State Budget 2003, for instance, aid to the agricultural sector foresees financial support of cattle and plant production (Article 2801210), financial support of farmers (art. 2801230), financial support of agricultural enterprises in difficult climatic conditions (art. 2801280), etc. CMU is responsible for distributing financial support to the final recipients via its decrees or the orders of other ministries responsible for a particular sector. State budget as well as treasury reports does not show which enterprise receives subsidies.

Competition is protected by the Law of Ukraine "On the protection of economic competition" (#2210-III, 2001). There are a number of laws dealing with responsibilities of Antimonopoly Committee and protection of entrepreneurs from unfair competition (e.g. the Law "On protection from unfair competition", 236-96-BP,



1996). However, presently, Antimonopoly Committee of Ukraine can only be involved in the area of state aid if this aid creates monopolistic conditions in the market or prevents other enterprises from entering a particular activity.

### **3.6. Principles concerning wages and salaries in the public sector**

Total funds devoted to the remuneration of labor as well as the level of wages in public sector is determined by legislative acts and is specified separately for executive authorities, local governments, their executive authorities, offices of prosecutor, courts, etc. and other organization and institutions of the public sector.

The main document that regulates the system of remuneration of labor in Ukraine is the Law of Ukraine "On the Remuneration of Labor". It establishes the main rules for wage payments in enterprises of any ownership type. According to the Law, wages in budget sector are to be determined on the basis of tariff scale, tariff rates of the first tariff class and wage-rates and skills handbook. The wage of the first tariff class should not be lower than minimum wage established by the respective Law for the current year. In fact, the tariff scale is a system of coefficients. These coefficients show the ratio between the wage of worker of a specific grade and wage of the worker of the first tariff class.

However, currently the system of setting wage schedule (that is nominal wage payments) is used in the public sector. The Resolution of CMU (#2288) establishes wage rate schedules of the leading employees, experts and personnel of the President Administration, the Cabinet of Ministers and its Secretariat, Verkhovna Rada, the Accounting Chamber, central and local executive bodies, the Council of Ministers, ministries and republican committees of the Autonomous Republic of Crimea, local councils, courts and prosecutor. This document mainly establishes wages paid to workers of the specified bodies giving some fraction of range. Moreover, it regulates the amounts of additional payments provided to employees and reasons for such provision. The Ministry of Finance controls the use of funds for remuneration of labor by executive authorities, bodies of prosecutor and courts, and other bodies financed from the State budget.

Moreover, there are active resolutions of CMU and orders of the Ministry of Labor that establish the wage level for employees working at budget sector. The main document is the respective resolution of CMU (#134) that establishes wage schedules for the employees in educational, health care sectors of the economy.

Therefore, currently remuneration of labor in public sector is based rather on wage schedule than tariff scale system established by the Law "On the Remuneration of Labor". The main difference between the tariff scale and wage schedule systems is that while in the former a wage increase of the first tariff class means the raise of wage payments for all other employees, the latter one does not have this provision. In the wage schedule system an increase in wage of some employees does not cause any recalculations for others. Due to the existence of this system, the minimum wage increase initiated in 2002 and 2003 led to lowering the inter-qualification wage differences, since an increase in wages of low-paid employees was not followed by a respective changes in the wage of other groups of employees.



In order to solve the problem, the system is supposed to be transferred to the required tariff rate. For this purpose the Cabinet of Ministers approved the Resolution "On the remuneration of labor on the basis of Unified tariff scale of classes and coefficients for remuneration of labor of employees working in all institutions, organizations of budget sector" (adopted in August 2002). This Resolution regulates setting of tariff scales and tariff rates for employees in budget sector. According to this Resolution, tariff scale includes 25 tariff classes (grades), and the ratio between the highest and the lowest class is 4.51. The Ministry of Labor is obliged to set the wage rate for the employees of the first tariff class, which is supposed to be not lower than the minimum wage. The Resolution is to become active from January 1, 2004.

In addition to the legislative documents that establish the terms of the wage payments in the budget sector, there is a resolution of the Cabinet of Ministers that establishes employment limits and the size of remuneration of labor of employees in oblast, Sevastopol city, and rayon local state administrations (№380, 26.03.03). Moreover, employment limits are also set for the apparatus of local state administrations.

Another Resolution of the Cabinet of Ministers (№403, 26.02.00) establishes employment limits for the Ministries of Ukraine and other executive bodies including their central bodies (also the number of deputy heads) and subordinated regional bodies. The employment limits of any body can be changed through approving amendments in respective resolutions, depending on its tasks.

Each year State Budget Law determines the funds dedicated to each ministry, and within these limits ministry defines the amount of remuneration of labor for its employees and subordinated bodies. Local authorities define respective funds for the educational, medical and other budgetary entities within the limits of staff lists and established official wages. Inter-budget transfers<sup>21</sup> take into account the needs of the local budgets in financing education, health care, cultural and social sectors in their region including remuneration of labor in those sectors.

Though wage payments are among primary items for budget financing, there are wage arrears in the budget sector of Ukraine. As of April 1, 2003, wage arrears from budget funds exceed UAH 44 m (about 2% of total wage arrears in the economy), and 90% of them constitute wage arrears from the state budget.

### **3.7. Making investment decisions**

In Ukraine, investment planning is open to public on a case-by-case basis. There are several types of investment activity with public participation: capital investments from the state and local budgets; public-private investment projects; and investment by the state firms and enterprises with state shares.

The procedure for capital investments with participation of public funds is outlined in the Decree of CMU "On the order of appraisal and tenders for the selection of investment projects foreseeing the participation of funds from the state budget" (#2145, 1999).

If capital investments are financed from the state budget, the following three-tier procedure for selecting investment projects is applied. At the first stage, enterprises

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<sup>21</sup> The Ministry of Finance is responsible for the calculation of the transfers.



that seek participation of public funds in their investment projects may ask sectoral ministries and deputies to represent their projects in the fund sharing process. The ministries choose the projects on the basis of their priorities and economic appraisal, and it is impossible to challenge the decision of the ministry or ask for revision of the application. The procedure does not seem to be entirely transparent as sometimes in the application process it is not an enterprise that approaches the ministry, but rather the ministry and the deputies are selecting the enterprises and projects they want to support with investment funds for policy reasons.

At the second stage, sectoral ministries submit the winning proposals to the Ministry of Economy and European Integration. This Ministry determines which projects to finance from the state budget. Then, it forwards the winning applications to the Ministry of Finance and asks to include these projects into the planning of the state budget for the next year.

At the third stage, 20 days after the State Budget Law of Ukraine is adopted, the Ministry of Economy and European Integration conducts the final selection of the investment projects taking into account the amount of funds allocated to financing state capital investments. The enterprises that receive capital investments from the state budget are listed in respective decrees of the Cabinet of Ministers.

The same procedure is applied if a private party seeks state participation in its projects. However, chances of private parties to get capital investment funds from the government are rather slim since most of capital investment goes to social infrastructure projects.

If private investment is sought by the government as additional to public investment, then the plans for such projects are open to public as, for example, in the case of concession for construction of the roads (e.g. a consortium was created to build the road Lviv-Krakovets with government participation). Concession activity of the government is regulated by the Laws of Ukraine "On Concessions", "On concessions for the building and operating automobile roads" and by decrees of the Cabinet of Ministers.

Information on investment projects of state enterprises or joint-stock companies with state shares is not available to public. Investment decision is taken by management of the enterprises and financed from their own revenues.

To summarize, while investment projects of state-owned enterprises as well as firms with state shares are considered to be their internal matter, plans for concessions and attraction of private capital to the projects initiated by the government are made public, and selection procedure for these projects is usually an open-bidding one.

### **3.8. Procedures concerning closing of accounts of the state budget**

Article 57 of Budget Code states that budget accounts have to be closed at the end of the year. The letter of the State Treasury of Ukraine explains the procedures and accounting to be followed by budget organizations and establishments. The Order of State Treasury #3 defines the accounting process of the end-year closure of accounts. Some of state budget accounts can be closed within a year, if there are changes in legislation or reasons for indisputable writing-off.



The Budget Code of Ukraine determines December 31 or the last day of another budget period as the date of the closure of budget accounts. According to Budget Code, Minister of Finance can define another term if extra-ordinary conditions exist. For example, he exercised his right in 2002 and prolonged this date till January 9 (Art. 57).

Budget Code of Ukraine defines only general principles for budget accounting. State Treasury of Ukraine and Ministry of Finance are empowered to set the standards of accounting and reporting agreed with the Accounting Chamber. The only legal requirement is that reports have to be made using the data of Treasury. However, the expenditures are not always made according to the legislation. For example, expenditures on state support of coal mining can be made from the account assigned to the restructuring of coal mining. Accounting Chamber of Ukraine regularly reports about the misuse of budget funds.

Expenditures from the general fund of state budget expire at the end of the year, if they have not been used for the assigned tasks. With respect to special fund, the Treasury preserves the residual funds for its further special use in the next budget period.

The form of the final accounting does not contain notes specifying the accounting details. Budget outcome is evaluated on a cash basis.

### **3.9. The principles of public borrowing**

According to Articles 60 and 61 of Budget Code and the Order of Ministry of Finance "On the Procedure of Accounting of State Debt and Operations Connected with it by the Ministry of Finance", the government should disclose the information on state debt (in quarterly and annual reports on central budget execution) and prepare detailed explanatory notes as for changes in state debt of Ukraine. In the Law "On Domestic State Debt" it is stipulated that Ministry of Finance has to publish annually information on state debt. However, legally it is not clearly specified what kind of information on state debt should be disclosed. In practice, Ministry of Finance discloses to media on the monthly basis updated information on main state debt indicators. This information usually includes total volume of state debt (both in national currency and U.S. dollars), volumes of external and domestic debt, and volumes of direct and guaranteed debt (both external and domestic), as well as expenditures on state debt servicing and redemption (separately for external and domestic debt). Moreover, the government usually discloses the information on its debt in dynamics making comparison much easier. Regular budget execution reports contain the information on state debt in flow terms, i.e. the amount of borrowings acquired and repaid in the reporting period. Besides, in the explanatory note that supplements the draft of Central Budget Law for the next year, there is quite detailed information on state debt. Specifically, explanatory note includes the program of state borrowing for the next budget period and volumes of domestic (both in U.S. dollars and hryvnia) and external state debt for the last four years. Moreover, total volume of foreign debt for the last four years is divided into three categories: debt to international organizations (World Bank, EBRD and European Union), debt to countries (main creditors are specified) and debt to foreign commercial banks. Also, detailed information on guaranteed debt is disclosed. Finally, in the explanatory note the government presents calculations of future domestic and foreign debt repayments for the next 30 years. So,





during the last several years, extensive information on state debt performance was provided. That is related to the adoption of Budget Code. Moreover, Draft Law "On State Debt" that is currently discussed in the parliament, envisages increasing the transparency of state debt management in Ukraine, obliging Ministry of Finance to disclose regularly information on main state debt indicators. However, in contrast to international standards, the government does not disclose any information on its financial assets, i.e. marketable securities, investments and loans to enterprises and other entities etc.

The definition of domestic state debt is given in the Law "On Domestic State Debt". According to this definition, domestic state debt of Ukraine is represented by liabilities of the Cabinet of Ministers of Ukraine in monetary form. So, the liabilities of public entities are not considered to be the part of state debt, while there is no legal definition of public debt of Ukraine.

Monthly and annual reports on budget execution show only operations connected to the direct debt, i.e. amounts that have been borrowed and repaid during the reporting period, while state guarantees that come into the force are not shown in the budget report.

National Bank of Ukraine is prohibited from direct state budget deficit financing (Article 15 of the Budget Code and Article 54 of the Law "On the NBU"). However, the government from time to time tries to involve National Bank in various quasi-fiscal operations (for details see Part 1.5).

Article 18 of Budget Code states that direct state debt should not exceed 60% of GDP. Maximum size of external and internal debt for every year is set by the State Budget Law, which means that all state debt operations for a given year are conducted within the limits set by Budget Law. Moreover, budget laws usually contain the provision that if annual plan for domestic (foreign) borrowings is not fulfilled (i.e. domestic (foreign) debt is lower than the maximum set by law), it is allowed to exceed maximum level of foreign (domestic) debt by the amount for which limit on domestic (foreign) debt has not been reached.

According to the Law "On Domestic State Debt", Ministry of Finance conducts public debt management. Specifically, Ministry of Finance performs all operations concerning redemption and servicing the debt, and making new borrowings. Ministry has to coordinate state debt management activity with the National Bank of Ukraine. In addition, Verkhovna Rada has the right to set maximum limits for domestic and foreign debt for the current year, as well as to increase these limits.

According to the Article 17 of Budget Code, Ministry of Finance, authorized by the Cabinet of Ministers, may grant state guarantees. The Law on Central Budget sets further regulations of this issue. Specifically, Article 13 of the Law "On the State Budget 2003" stipulates that state guarantees cannot be provided in the current year, except of guarantees for loans given by international financial institutions in case their redemption has to be made from funds of the central budget. At the same time, the Law does not set any explicit limits on the size of guarantees that can be provided in the current year.

Acting law "On domestic state debt" requires that state debt of Ukraine is classified according to maturity profile (short, medium and long-term). Ministry of Finance also discloses the classifications of state debt by the currency of denomination (national and foreign) and by the type of lender (for domestic debt - banking institutions and



legal entities). Draft law "On State Debt" envisages also the classification of public debt by the type of interest rate (fixed versus variable)

Since outstanding debt is equivalent to direct state debt, the information on it is regularly disclosed by the Ministry of Finance.

### **3.10. Ethical standards of behavior for public servants**

Public service regulation: The Law of Ukraine "On Public Service" (#3723-XII from 1993) regulates legal, organizational, economical and social issues public service. In addition, it determines general issues of activity as well as status of public servants who work in state structures and their apparatus.

Public service is defined as professional activity of individuals who occupy the positions in state bodies and their offices, which are connected to the practical fulfillment of the tasks and functions of the state, and receive wages from the state budget. These individuals are public servants and have respective responsibilities. State officials represent a special group of public servants and include heads and deputy heads of the state bodies and their offices, other public servants who pursue management and consulting tasks and are involved in decision-making.

According to the Law, the right for occupying public service position belongs to the citizens of Ukraine regardless their origin, property, race and nationality, gender, political views, religious beliefs, and place of living. They have to have proper education and professional training and participate in the competitive selection process, or other procedures foreseen by CMU.

The Chief administration of public service: Verkhovna Rada determines state policy concerning public service. The Law states that *the Chief administration of public service at the Cabinet of Ministers* conducts the unified public policy and functional management of public service. However, in 1999, President passed new regulation (N1272/99 from 1999), which puts the Chief administration of the public service under the control of the President of Ukraine. The Head of the Administration is appointed and dismissed by the President. The specific term of his presidency is not defined by any legislative acts.

Legal status of the President, the Head of the VR and his deputies, heads of the permanent committees of VR and their deputies, people deputies, Prime-minister, members of CMU, Head and members of the Constitutional Court of Ukraine, Head and judges of the Supreme Court, Head and arbiters of Supreme Arbitrage Court, General Public Prosecutor and his deputies is regulated by the Constitution and a special Law of Ukraine.

Moreover, the Resolution of CMU (#676 from 2003) establishes the procedure of appointment and dismissal of the heads of the structural subdivisions (department, administration) of central executive bodies. Their appointment needs an approval by the Prime-Minister and Vice-Prime-Ministers.

The Law "On Public Service" regulates the legal status of public servants who work in the offices of the prosecutions bodies, courts, diplomatic service, custom control, internal affairs, etc.

Recruitment rules: The Law regulates the issue of recruitment in public service. First of all, people cannot be selected or appointed for the position in the state office and



apparatus, if they are incapable persons, have convictions that are incompatible with potential occupation, or might become directly subordinated to their close relatives. The recruitment in public service is performed on the competitive basis (except of cases foreseen by Laws of Ukraine) defined by CMU.

At the same time, the President of Ukraine, the Head of the VR, members of the government, the heads of the local state administrations have a right to select and hire independently people for the positions of their assistants, heads of the press-services, advisors and secretaries in accordance with staff schedule and category that correspond to the position.

For other positions, the information of open vacancies of public servants is to be published and distributed via mass media not later than one month before the competition starts. The recruitment is based on the results of an exam which checks the knowledge of the Constitution of Ukraine (one question), Laws of Ukraine "On the public service" and "On the fight against corruption" (one question from each Law), as well as of the legislation that takes into account the specifics of functional authorities of corresponding state institutions and structural subdivision (two more questions) (the Resolution of CMU, №169 from 2002). The first three questions should be selected from the list presented in the Regulation of the Chief administration of public service (№30/84 2002). During the competition for position of public servant, the preferences are given to candidates with respective scientific degree and knowledge of foreign languages, or to those who have received high education in developed countries or worked abroad, or has managerial experience in public enterprises. The recruitment decision is made by the commission consisting of Head of the commission (usually the deputy head of the state body), secretary and members (representatives of personnel and legal departments and structural subdivisions of the state body).

The Guide of typical professional characteristics of public servants determines the requirements to the content of professional activity, skills and responsibilities of public servants. According to the Guide, public servants have to know main issues of law, political science, economics, administration, finances, ecology, social and humanitarian subjects. They have to be fluent in state language. Those public servants, who are expected to make decisions concerning accomplishment of inter-governmental relations, have to know one of the foreign languages at the basic or professional level<sup>22</sup>.

Recruitment of public servant involves a probation period that lasts up to six months. In order to obtain practical experience, test the professional level and qualities of an individual applying for the position at public service, there is a possibility of two-months internship in the corresponding state office with reservation of the wage at the main working place. Furthermore, career development of public servants is organized as a promotion within the ranks and categories set by Law. A position of a higher rank can be also obtained on a competitive basis. Public servant can be transferred to a different job and even to a different office if he/she meets the requirements of new position.

The Ministry of Economics and European Integration conducts annual evaluation of its public servants who work in trade missions within the diplomatic structures of Ukraine

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<sup>22</sup> However, as evidence illustrates, even at the Ministry of Economy and European Integration less than 50% of public servants have good knowledge of foreign languages. Moreover, not all public servants have fluent knowledge of Ukrainian.



abroad. Evaluation criteria include efficiency in fulfilling tasks and responsibilities, professional competence and ethics of behavior. The results of the evaluation are taken into account while considering prolongation of employment and career development of public servants.

*Dismissal of public servants:* Labor Code provides conditions for the dismissal of any employee. The Law "On public service" sets additional conditions of dismissal for public servants. They include abuse of power; involvement in corruption; retiring age; withholding or providing wrong data concerning their incomes, etc. The change of the leadership in public bodies cannot be the reason for dismissal of public servants, except for those in patronage service. However, the Law does not clearly define the procedure of dismissal of public servants.

High-ranking public servants can resign on the basis of the following reasons: principle disagreement with the decision of the state office or particular officials; ethical obstacles for being employed in public service; pressure to fulfill the decision of the state office that violates current legislation or can cause material or moral damage to the country, enterprises, institutions, organization, and citizens; health problems. Within one month after application for resignation is submitted, the public office that has appointed this public servant either accepts it or provides a motivated refusal. If resignation is not accepted, a public servant has to continue accomplishing his official duties and can use his right of dismissal as defined by the Labor Code.

*Wages of public servant:* According to the Law, the wages of public servants consist of official salary, bonuses, additional payments for ranks, years of work in public service and other bonuses. The Cabinet of Ministers defines the conditions of the remuneration of labor of public servants, the amounts of their official salaries, additional payments, bonuses and welfare benefits.

There is no explicit data for the average salary of public servants. The data is available for employees of state management, which includes public servants as well as other public servants. In March 2003, it constituted UAH 525 (126% of the average wage in Ukraine).

*Code of ethics:* Currently, the ethics of conduct for public servants are defined by two laws: 1) The Law of Ukraine "On the public service" ((#3723-XII from 1993), 2) the Law of Ukraine "On the fight against corruption" (#356/95 from 1995) and "General ethical standards of behavior of public servants" set by the Order of the Chief state administration of public service (N<sup>o</sup>783/5004 from 2000).

The Law "On the Public Service" describes main ethical norms for public servants: public servants have to fulfill their responsibilities conscientiously; treat citizens, supervisors and colleagues with respect; demonstrate high culture of communication; prevent actions that can harm the reputation of public servants.

General ethical standards of behavior for public servants summarize ethical standards for public servants. They determine main responsibilities of public servants and provide a definition of the conflict of interest.

All specified documents devote special attention to prevention of corruption.

*Corruption:* In the Law "On the Fight against Corruption", corruption is defined as an abuse of power by individuals authorized by the state to perform special functions, in return for goods, services, privileges or other benefits or advantages. Public servants, people's deputies, officials of the local governance are called to account for the



corruptive activity and other violations connected with corruption. They are subject to administrative and disciplinary proceedings. The issues of criminal, civil and financial penalties of corruptive activities are solved in compliance with the active legislation.

The bodies responsible for anti-corruption activities include the Ministry of Internal Affairs, tax police, Security service of Ukraine, offices of the public prosecutors, other bodies and subdivisions created for fighting against corruption in compliance with the active legislation. In order to coordinate the activity of these state bodies, the Coordination Committee on the Fight Against Corruption and Organized Crime has been created under the control of the President of Ukraine (Decree of the President, №402, 13.05.03). The main task of the Committee is to pursue the state policy concerning the fight against corruption and organized crime, and develop the strategy to prevent corruptive practices. This Committee can initiate the cases against the public officials who violate their responsibilities concerning the prevention of corruption.

The Law also defines the activities forbidden for accomplishing by public servants. They include such as:

- use of the official status of public servant for supporting physical persons and legal entities in their entrepreneurship activity (including receiving subsidies, credits, privileges, etc.) in return for unauthorized material benefits, services, privileges or other benefits;
- performing entrepreneurship activity directly or through intermediary, and combining jobs (except of scientific, teaching, creative activity as well as medical practice);
- being (independently or through intermediary) a member of the Board or other executive bodies of the enterprises, financial intermediaries, economic communities, etc. (except of the cases, when they are involved in management of state-owned shares);
- refusing physical persons and legal entities in providing information which has to be disclosed according to the active legislation provision, as well as deliberately delay it or provide invalid or incomplete information.

If public servants are found in performing corruptive activities, they are subject for fines. Moreover, they can be fired with canceling the right to occupy positions in public service for the next three years or forever. Public servants can be drawn to the correction works or imprisoned for the abuse of power, falsification, negligence and bribes in large amounts (The Criminal Code of Ukraine, Section XVII).

Both Laws also include the provision for the financial control, which aims to avoid corruption. Thus, the article 6 "Financial control" of the Law "On the fight against corruption" foresees three kinds of financial control:

- revenues declaration;
- announcement on the opening of the foreign exchange account in a foreign bank;
- annual publication of the report on revenues, assets, property and deposits in banks.

The revenues declaration of public servants is done according to the procedure and on the basis defined by article 13 the Law "On public service". In addition, this article differentiates the volumes of information on revenues that have to be declared depending on the category of public servant's position.



However, currently implementation of the Law "On the Fight against Corruption" is far from being effective. It is a common practice for people's deputies to run own business through relatives or intermediaries. Moreover, corruption is common on the local level when it concerns business registration and licensing.

Regardless all established codes of ethic Ukraine remains on the top of the list of the most corrupted countries in the world. According to the Global Corruption Report 2003, in 2002, corruption perception index (CPI)<sup>23</sup> for Ukraine constituted 85 (out of maximum equal to 102).<sup>24</sup> Moreover, the 2001 survey by the U.S.-based NGO Committee to Protect Journalists cited Belarus, Russia, Ukraine and Uzbekistan as the worst offenders against press freedom.<sup>25</sup>

In order to tackle the corruption problem, the National program of the fight against corruption (the Decree of the President of Ukraine #319-97, 10.04.97), the Concept of the Fight against Corruption for 1998-2005 (the Decree of the President of Ukraine, #367/98 from 1998), The Plan of actions aimed at strengthening the fight against organized crime and corruption in 2003 (the Resolution of the CMU, #270-p from 2003), etc. have been adopted. The measures proposed in these documents include: political (improvement of the legislation), economical (increase of the public servant wage, improvement of tax system, etc.), organizational and administrative (administrative reform) actions, etc.

Some NGOs investigate corruption practices in Ukraine. For example, the Center of Anticorruption Research represents the department of Transparency International Organization. Its main tasks is to assist the fulfillment of state, regional and international programs directed to the improvement of social-economic situation through strengthening principles of openness, honesty and objectivity in the activity of the government.

High level of corruption is one of the factors that cause large shadow economy in Ukraine. Ministry of Economy and European Integration estimates the size of shadow economy using different methods: financial, monetary, electricity consumption, etc. Similar estimations are done across the sectors of the economy. Presently according to estimation of the Ministry, shadow economy equals to 42.3% of Ukrainian GDP. There is no detailed information on the methodology of estimation, since it is not yet officially approved.

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<sup>23</sup> The CPI is defined as the misuse of public power for private benefits. It used the data collected between 2000 and 2002 and is composed from 15 data sources from nine different institutions.

<sup>24</sup> Ukraine shares the same rank with Georgia and Vietnam.

<sup>25</sup> Global Corruption Report 2003.



## 4. AUDITING PUBLIC SECTOR

### 4.1. External Audit

According to Budget Code (Article 26), external control and audit of financial and business activities of budget entities is exercised by the Accounting Chamber (with respect to supervising the execution of the state budget funds) and the Chief Control and Auditing Administration of Ukraine.<sup>26</sup>

However, according to international standards reflected in IMF Manual of Fiscal Transparency (Article 168), only Accounting Chamber of Ukraine can be named an independent national audit body that exercises external audit: it is not under the control of Ukrainian government, and the appointment/dismissal of the chief auditor is done independently from executive bodies.<sup>27</sup>

At the same time, according to the international standards described in the Manual, the Chief Control and Auditing Administration (CCAA) can be considered as an internal auditor, since it is a part of the executive branch of the government. The only kind of audit, that CCAA defines as the external audit (appealing to the Budget Code) concerns auditing the activity of budget entities and effectiveness of the usage of budget funds during the implementation of state programs. The latter type of audit CCAA has started rather recently (in 2002) – from checking effectiveness of the state programs in education and agricultural sectors. Auditing reports include analytical overview of the sector, analysis of the results of program implementation and evaluation of the efficiency of targeted spending of budgetary funds for the achievement of program goals. Further description of the activity of Chief Control and Auditing Administration is presented later in the Part on *Internal Audit* (4.2).

The Accounting Chamber (ACU) is an independent national auditing body, which is accountable to Verkhovna Rada (VR). The legal basis for the activities of ACU is provided by the Constitution of Ukraine, the Budget Code and the Law “On the Accounting Chamber” (#315 VI from 1996). According to the Constitution of Ukraine (Article 98), ACU controls the execution of state budget expenditures on behalf of VR. The Law defines its status, functions, and responsibilities. Currently, ACU is a member of INTOSAI (International Organization of Supreme Audit Institutions) and EUROSAI (European Organization of Supreme Audit Institutions).

The Accounting Chamber consists of the Head of the Chamber and the members of the Chamber: the First deputy and deputy head, main inspectors and the Secretary of the

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<sup>26</sup> In Ukraine, there is no explicit definition of such terms as external and internal audits. The Budget Code just defines the entities that are conducting each type of audit.

<sup>27</sup> According to the IMF Manual of Fiscal Transparency the major important features of independent national audit bodies (NAB) are: 1. They should not be under the control of the government; 2. Establishment of the NAB is to be laid out in the constitution; 3. Establishment of procedures independent of executive for the appointment and dismissal of the chief auditor; 4. The chief auditor should be allowed to report directly to the legislature, etc.



Chamber. ACU has personnel whose size and structure are to be approved by the Board of ACU on the proposal of the Head within the limits of ACU funds.

The Head of ACU is appointed by VR through the secret voting on the proposal of the Head of VR for the period of seven years. The candidate for the position of the Head of ACU has to be appointed by the absolute majority of votes from the constitutional number of people deputies in VR. He/she governs the Chamber, represents it in VR and other bodies of the central government of Ukraine and abroad, and presents reports of ACU.

The First deputy head, deputy head, main inspectors and Secretary are also appointed by VR through the secret voting on the proposal of the Head of ACU for the period of seven years. The Head of ACU, the First deputy head, deputy head, main inspectors (heads of departments), and Secretary are not allowed to perform entrepreneurial activities, be members of the government or people deputies, and combine jobs (except of teaching, scientific and other creative activity conducted in free time).

Other employees of ACU are hired on the competitive basis and dismissed in compliance with the Law of Ukraine "On Public Service" (see Part 3.10).

The Head of ACU, First deputy and deputy, main inspectors and Secretary can be dismissed on the request of the Head of VR in case of:

- violation of the legislation of Ukraine or abuse of power (this case is decided by VR);
- resignation;
- long-term disease, confirmed by medical institution, which impedes their activity on the respective position;
- retirement age (65 years old).

The dismissal decision is voted in VR and needs the majority from the constitutional number of deputies.

The Board of ACU includes the Head of ACU, the First deputy head and deputy head, as well as main inspectors, and Secretary. It deals with the issues of planning and organizing ACU's work, methodology of control and auditing activity, takes the decisions on conducting inspection and audits and prepares the reports of their results.

According to the Law, ACU is financed from the State budget of Ukraine. The respective amount of funds is set by VR and is specified in the State Budget Law in a separate row. The activity of officials of ACU is also controlled by the law "On public service", and they are public servants. The salaries of ACU's employees are defined by the Resolution of the Cabinet of Minister, and are set at 30% higher level than that for other public employees.

ACU conducts scheduled and unscheduled inspections and audits (The Resolution of the ACU's Board, #25-14, 03.12.99). The former are conducted on the basis of annual, semi-annual, and quarterly working plans of the Board, departments and other structural subdivisions of ACU. Unscheduled inspections and audits are conducted according to the decision of the ACU's Board and on the basis of resolutions, protocol decisions and appeals of VR, its committees and deputies, appeals and proposals of the President and the Cabinet of Ministers.





The majority of audits of ACU are of ex-post nature. However, it also conducts ex-ante expertise of draft laws on the State budget of Ukraine, drafts of other legislative acts, international agreements, state programs and other documents concerning the state budget and state finances of Ukraine. Thus, on the request of VR, ACU has to make an examination and provide conclusions on:

- the Draft law on State budget of Ukraine;
- drafts of legislative acts concerning monetary and fiscal systems;
- drafts of the state targeted programs that are completely or partially financed from the budget;
- drafts of the programs of Cabinet of Ministers.

In addition, ACU provides reports after considering appeals of the President, people deputies, the Cabinet of Ministers and the Ministry of Finance.

While planning its control activities, ACU takes into account 1) the results of systematic monitoring and analysis of financing all types of expenditures of the State budget, and the use of the funds of state extra-budgetary institutions in the previous period as well as during the respective period of current year, 2) current legislative and normative base which regulates corresponding issues, and 3) special issues of real sector development, in particular use of the State Budget funds.

In order to conduct its activity, ACU has 10 departments, which ensure fulfillment of the following tasks defined by Budget Code:

- control over expenditures on judicial authority, defense, law-enforcement activity and state security;
- control over expenditures on agricultural sector and industrial infrastructure;
- control over expenditures on social sphere and science;
- control and analysis of the budgets;
- control over expenditures from targeted budget funds and state extra-budgetary funds;
- control over execution of state budget funds in regions;
- control and analysis of expenditures on state administration;
- control over expenditures on industry and energy sector;
- control over public debt and banking activity;
- control over compliance with budget legislation.

The main aim of inspections and audits is to check the legality and efficiency of using: 1) State budget funds; 2) funds of state targeted funds and extra-budgetary funds; 3) credits and loans received by Ukraine from foreign countries and international financial organizations; 4) funds of NBU.

ACU reports to VR on the results of inspections and audits (including information on violation of law, and damages caused to the state). If ACU discovers violations of law, it approaches the President of Ukraine, Cabinet of Ministers, and other central executive bodies in order to call to account public officials responsible for law violation.



In case asset stripping or corruption is discovered, ACU must immediately inform VR and transmit relevant audit documentation to law-enforcement bodies.

If discovered violations are not connected to the execution of the State budget, and, thus, are out of ACU authority, they are reported to the Board of ACU and law-enforcement bodies.

Every year not later than on December 1, ACU has to submit to VR its report on the results of the fulfillment of VR appeals, conducted inspections and audits, as well as their costs. The Report of the ACU, approved by the Verkhovna Rada, is published in the VR publications and is available on the ACU's web-site.

Moreover, ACU's conclusions on the execution of the State Budget have to be presented to VR within two weeks after the formal submission of the annual report on the State Budget execution by the Cabinet of Ministers of Ukraine.<sup>28</sup> After receiving conclusions of ACU, VR reviews the report on State budget execution within another two weeks. Together with the report of CMU (presented by the Minister of Finance) on the State Budget execution, the Heads of the VR Budget Committee and ACU are supposed to present the co-report during the session of VR.

In order to fulfill its tasks, ACU also:

- conducts expert and analytical, informational and other kinds of activities concerning use of the budget funds.;
- checks financial documents, bookkeeping, reports, plans, budgets and other documents concerning financial and economic activity as well as conducts the audit of operations with cash and assets;
- controls the use of State budget funds during the reporting period and submits a quarterly report on the execution of the State budget to VR;
- analyzes the violations of budget process, presents to VR proposals concerning their elimination as well as improvement of the budget legislation;
- presents to VR and its committees evaluation of the execution of the State budget, including revenues and expenditures of the targeted funds, state programs.

According to the Law and the resolutions of ACU's Board (#891/4184 from 1999), the following bodies are subject to inspection and audit by ACU:

1) at the central level:

- the administrative department and secretariat of VR;
- the Administration of the President;
- the bodies of Cabinet of Ministers;
- ministries, state committees, other central executive bodies, state targeted and extra-budgetary funds;
- the National Bank of Ukraine, the Antimonopoly committee, The State property fund of Ukraine, bodies of the State treasury;
- the Constitutional, Supreme and Supreme Arbitrage Courts;
- the Main Public Prosecutor, the Supreme Council of Justice;

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<sup>28</sup> Budget Code, the article 62



- bodies of the national security and defense;
- other judicial, law-enforcement and controlling bodies;

2) at the local level: local state administrations and bodies of local governments;

3) other bodies (enterprises, organizations, banks and credit institutions, other financial organizations and their unions, associations, non-state funds and NGOs) regardless their ownership type, but only with respect to their execution of state budget funds.

Regular audits are normally conducted by the ACU's staff. However, in case of necessity ACU can use experts of other organizations and institutions, including control, tax and law-enforcement bodies.

The terms and scope of inspections are set by the ACU's Board. ACU has a free access to all premises and documents of the inspected entity. If inspection falls under the jurisdiction of both ACU and another state control body, it is conducted by both control authorities simultaneously.

Inspections/audits of ministries and other central executive bodies include checking:

- the legality and effectiveness of use of the resources coming from State Budget and state extra-budgetary funds;
- targeted use of state budget funds received for financing targeted scientific and technical programs;
- economic effect from implementation of completed scientific and technical projects financed from the state budget;
- expediency and effectiveness of using investment funds;
- use of funds for administration allowances, etc.

Inspections/audits of the entrepreneurial entities regardless its ownership type if they received financing from the State budget, are focused on checking:

- legality, expediency and efficiency of using state budget funds;
- the consistence with the State Budget Law;
- targeted use of the state budget funds;
- the achievement of the planned results.

After conducting inspections/ audits, ACU presents its conclusions to the heads of inspected entities for ensuring the elimination of disclosed violations, and compensation of losses caused to the state. If heads of the audited entities do not agree with the conclusions, within 5 days they may submit their comments to ACU. Within next 5 days, ACU presents its response along with new conclusions to the head of the inspected entity for signature. Then, all auditing documents are passed to ACU's Board for making relevant conclusions. The resolutions and conclusions of ACU's Board are sent back to the inspected entities. Their implementation is obligatory for all state bodies, enterprises, organizations and institutions regardless of their ownership type and subordination. Within next 15 days, entities have to notify ACU about implementation measures.

However, this is not always the case. According to the Report of ACU on its activity in 2001, out of 32 direct proposals, only 23 were taken into account, including 18



proposals related to the Law of Ukraine On the State Budget 2002. Their implementation led to the preparation of new legislative and normative acts.

According to the Report of ACU, often the heads of inspected entities do not follow the conclusion of the ACU's Board. Sometimes, inspected bodies refuse to provide inspectors with full information.

ACU regularly informs public about the results of its inspections/audits through mass media. The annual report of ACU is regularly published.

## 4.2. Internal audit

According to the Manual of Fiscal Transparency, internal audit covers both audit of an agency by itself (ideally, reporting directly to senior management) and audit of an agency by another agency (e.g., by auditing body which is under control of Ministry of finance or Prime minister). In Ukraine, internal audit is conducted by ministries and other central executive bodies, as well as by State control and auditing service of Ukraine.

According to the Budget Code (Article 26), spending units are responsible for organization of *internal* financial control and audit both within themselves and in the subordinated budget entities. Internal financial audits must be conducted at every stage of the budget process in order to ensure:

- on-going evaluation of the sufficiency and conformity of the activities of a budget entity with the requirements of internal financial control;
- on-going evaluation of the activities for their conformity with the established tasks and plans.

Head of a budget entity has to be informed about the results of any inspection, evaluation, investigation, research, or audit conducted by an internal auditing unit.

The Ministry of Finance has to verify compliance of state and local budgets with budget legislation at each stage of the budget process unless otherwise is stipulated by legislation of Ukraine.

Only in May 2002, Resolution of the CMU (#685) has approved the procedure of conducting the internal audit by ministries and other central executive bodies, thus, providing basis for their control and auditing activity. According to the Resolution, ministries, other central executive bodies and their territorial offices have to create control and auditing subdivisions, which are responsible for internal audit of their activity and the activity of subordinated enterprises, organizations and institutions. In central executive bodies the heads of such subdivisions are appointed and dismissed by the head of respective central executive body; and the appointment has to be approved by the Chief Control and Accounting Administration. Besides, the candidates for the position of heads of control and auditing subdivisions in ministries and other central executive bodies have to be previously authorized by the Premier-Minister, the First Vice-Premier-Minister, Vice-Premier-Ministers according to the division of their responsibilities, and the Minister of CMU. Heads of control and auditing subdivisions are the members of boards of the respective ministries and other central executive bodies, and are subordinated to the heads of central executive bodies. In addition, they are accountable to the Chief Control and Auditing Administration (CCAA).



According to the Resolution, the internal audit is an activity of control and auditing subdivisions aiming to provide ministries and other central executive bodies with the objective information on the use of budget funds and the effectiveness of economic activity in order to prevent inefficient use of budget funds. While conducting internal audit, the heads of these subdivisions have to take into account:

- provisions of the Budget Code and other regulations and legal directives;
- requirements of task-oriented, efficient, and economical management of functions of each structural department and proper division of functional duties;
- conformity with accounting requirements and the procedures for accounting control with respect to the assets, liabilities, revenues, and expenditures of the budget entity; and
- the need to assure the compliance of the activities of budget entity with the requirements of internal financial control.

Internal control is conducted on the basis of semi-annual plans made by the heads and confirmed by the heads of ministries, other central executive bodies, and their territorial bodies, and approved by CCAA. In order to eliminate the doubling of inspections and audits, the control and auditing subdivisions coordinate their activity with the State control and auditing service. Besides, unscheduled inspections can be conducted upon the request of the ministers, heads of other executive bodies or their territorial offices, with the notification of CCAA.

As of the January 1, 2003, only 34 out of 45 ministries and other central executive bodies have created independent control and auditing subdivisions.<sup>29</sup> Moreover, in many cases existing subdivisions have insufficient number of employees and, thus, cannot provide the effective financial control of subordinated enterprises, organizations and institutions. The legislative base concerning the activity of these subdivisions is not unified among ministries and other central executive bodies. For instance, some regulations on ministries and other central executive bodies do not stipulate audit if targeted and effective use of state budget funds.

**State Control and Auditing Service of Ukraine** The State Control and Auditing Service of Ukraine (SCAS) consists of the Chief Control and Auditing Administration (CCAA), control and auditing administrations of the Republic of Crimea, oblasts, cities of Kyiv and Sevastopol, control and auditing subdivisions in rayons, cities and rayons in cities. According to the Presidential Decree (#1265/2000), activity of CCAA is directed and coordinated by the Cabinet of Ministers of Ukraine through the Minister of Finance.

The main tasks of the State Control and Auditing Service of Ukraine are defined in the respective Law of Ukraine. They include conducting state control over the use of funds and assets, as well as authenticity of accounting and reporting in Ministries, departments, state committees, state funds, budget institutions, as well as enterprises and organization which receive resources from budgets of all levels and state currency funds. The state control is conducted in the form of inspections and audits.

According to the Budget Code (Article 113), agencies of the State Control and Auditing Service exercise control over:

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<sup>29</sup> Report of the Chief control and auditing administration for 2002.



- the targeted and efficient use of resources of the state and local budgets;
- the targeted use and timely repayment of loans guaranteed by the Cabinet of Ministers'; and
- compliance with accounting procedures and accuracy of reporting on the execution of the state budget and local budgets, as well as estimates of revenues and expenditures of budget entities.

The State Control and Auditing Service submits monthly reports on the implementation of the results of its inspections to VR and the Ministry of Finance.

According to the Law on SCAS, CCAA is managed by the head of CCAA appointed by CMU on the proposal of the Minister of Finance. In practice, it is the President of Ukraine who appoints and dismisses the Head of the CCAA (following the Presidential Decree). Heads of control and auditing administrations in the Republic of Crimea, oblasts, as well as Kyiv and Sevastopol cities are appointed by the Head of CCAA with the approval of the Council of Ministers of the Republic of Crimea, and oblast, Kyiv and Sevastopol local state administrations. In turn, they appoint and dismiss the heads of control and auditing subdivisions (departments and groups) in rayons, cities, and rayons in cities.

CCAA and control and auditing administrations of lower levels have the right to:

- inspect and audit financial and accounting documents, reports, budgets and other documents concerning receiving and spending money and assets by the ministries, state committees and other state executive offices, state funds, enterprises, institutions and organizations;
- have a free access to the industrial and other premises for their inspections;
- receive from NBU, commercial banks and other credit organizations necessary information on the activity of inspected entity, and from the other organizations and enterprises (including non-state entities)– copies of the documents on the operations with the insured entity;
- require the heads of the inspected entities to eliminate discovered violations of legislation, appeal to respective offices concerning elimination of budget financing in case budget resources have been used by the enterprises and other institutions with violation of current legislation.
- return to the State budget the funds that have been received by the inspected entity with violation of current legislation;
- impose administrative penalties on the heads and other officials of enterprises, institutions, organizations as it is foreseen by the legislation.

The control and auditing service cannot control tax payments of the inspected bodies. However, its activity can be focused on ensuring the budget revenues from non-tax sources (e.g. revenues from renting state property, dividends, repayment of a credits and loans provided at the expense of budget funds or received under state guarantees, etc).

The inspection or audit is conducted on the basis of documents signed by the Head of the State control and auditing service, head of the department, their deputies or heads of subdivisions in rayon, city or rayon in city.



The state control and auditing service may conduct an inspection/audit of the organization not more than once a year. However, law-enforcement offices can initiate an inspection / audit any time. In case of criminal investigation, control and auditing service conducts inspections /audits of the entities of entrepreneurial activity regardless their type of ownership on the basis of the resolution of a state prosecutor.

### **4.3. Public sector scrutiny**

Article 28 of Budget Code provides the list of documents, which have to be disclosed by Ministry of Finance to general public. It includes: 1) draft Law on State Budget of Ukraine; 2) Law on State Budget of Ukraine for the appropriate period with annexes as its integral parts; 3) information on the execution of the State Budget of Ukraine based on quarterly and annual statements; 4) information on indicators of the execution of the consolidated budget of Ukraine; 5) other information on the execution of the State Budget of Ukraine.

According to Budget Code, the draft Law on State Budget is to be published in press within 7 days after its submission to the Verkhovna Rada.

Budget Code also requires the legislature of the sub-national level to publish the information on local budgets, including decisions on local budgets and regular reports on their execution. Decisions on local budgets are to be made public within ten days after their adoption. Publication of local budget drafts and public hearings on budgets is becoming widespread in Ukraine. In Kyiv, for instance, budget and reports on budget execution are published in the regional newspapers.

Information on public finance is available on the web-site of VR Budget Committee (<http://budget.rada.gov.ua>). The information is up-to-date showing execution of every article of the budget, however it does not provide disaggregated data for local budgets. The web-site also offers other useful information related to the budgetary process such as news, comments by experts and politicians, draft laws that influence budgetary process, relevant legislation, the structure of Budget Committee, and tools for interactive communication.

The web-site of Ministry of Finance offers general news as well as information on state foreign and domestic bonds, external state debt. The information on the budget execution is less comprehensive than that on the web-site of the VR Budget Committee.

The President of Ukraine adopted a Decree "On additional steps to ensure the transparency in the activity of the state power bodies" (N325, May 17, 2001), which outlines the tasks for the state bodies to ensure the free access of citizens to the information within the state bodies.

The Cabinet of Ministers adopted a Decree "On the order of the publication in the Internet of the information on the activities of the executive bodies" (N3, January 4, 2002). (The decree was adopted following the Presidential Decree on the development of the Internet and ensuring wide access to this network of Ukrainian citizens). Among other things the CMU Decree requires the local governments to publish on their web sites the information on the execution of the local budgets. All of the bodies of the executive power are required to publish the information concerning the public tenders available within the body. This decree lists the minimal requirements concerning the



information, which should be available on the Internet web site of a governmental body (central or local level).

Control over the execution of the abovementioned decree and further steps of increasing the transparency of the government are described in the Decree of the CMU "On further steps on ensuring the transparency in the activities of the bodies of the executive branch" (N 1302, August 29, 2002). The local governments are to provide the information on the execution of the budgets, on the volume of subsidies and tax collections.

The main drawback of information, which becomes available to public, is its aggregated nature. Receiving of disaggregated data is difficult. For example, it is impossible to deduce from the budget articles the amount of state aid received by particular state enterprises. This information becomes available through appropriate decrees of the Ministries or Cabinet of Ministers only after spending units have made respective decisions.

#### **4.4. Responsibility for the violation of public funds management rules**

The State Control and Auditing Service can institute administrative penalties to the heads and other officials of the enterprises, institutions and organizations where the violation of laws has been found.

In case of violations of financial legislation (Article #164-2, The Code of the Administrative Violations of Law), the SCAS can impose the sanctions itself, including

- stopping operations with budgetary funds;
- suspending budgetary allocations;
- reducing budgetary allocations to the spending units.

In case of violations of budget legislation (Article #164-12, The Code of the Administrative Violations of Law), the SCAS prepares the report on administrative violation of the law. It registers the report in a special book and submits it to court, which makes a decision on penalties and fines.

If SCAS lacks the authority to investigate a particular violation and impose sanctions on violator through court, it forwards the results of the inspections/ audits to the Ministry of Internal Affairs, Security service of Ukraine or to the other organizations of financial control (such as State tax administration) with the appropriate powers. SCAS can initiate opening of criminal and civil cases. If the case is not opened, SCAS has the right to demand explanations and insist on its opening.

The Code on administrative violations' Article 164-12 "On violation of the legislation on budgetary system of Ukraine" specifies that mismanagement of public funds (such as misuse of funds for unauthorized targets, violation of rules for the conducting operations with budgetary funds) is punished by imposing the fine in the amount of 30 up to 70 non-taxable minimums. The same violations, if committed again during the same year after the fine was levied, are punished by the fine in the amount of 70 up to 100 non-taxable minimums.

If the violation is subject to Criminal Code, the SCAS forwards the results of the inspections together with supporting documents to the law-enforcement bodies for





investigation. The Criminal Code of Ukraine puts all mismanagement of public funds within a broader category of crimes against property and crimes in the sphere of economic activity.



## 5. LOCAL GOVERNMENT

### 5.1. Constitutional position of local government entities (LGE's)

Key notion in Ukrainian legislation is the **local self-governance** that is defined as a power of independent decision-making that is exercised by territorial community concerning the issues of local importance within the framework of Constitution and Ukrainian laws. **Territorial community** is represented by the residents, who permanently live in the villages, settlements and towns that constitute separate administrative-territorial units. Local self-governance is accomplished by the territorial community itself and by the LGEs.

**Local self-governance bodies** include:

- **Villages', settlements', towns' councils** - elective bodies that represent the interests of territorial communities and decide on their behalf.
- **Rayons' and oblasts' councils** that represent the joint interests of territorial communities of the villages, settlements and towns.
- **Executive boards** appointed by villages', settlements' and towns' councils as their executive bodies.

Local self-governance bodies and local state administrations constitute the system of **LGEs in Ukraine**.

**Local state administrations** implement the policy of central executive bodies at the local level, i. e. in rayons, oblasts, Kyiv and Sevastopol cities. Local state administrations include oblasts' and rayons' administrations, as well as Kyiv and Sevastopol<sup>30</sup> cities' administrations.

Local state administrations are the only entities among LGEs with subordinated status. Constitution and Law on Local Self-Governance regulate the issues of subordination and accountability of LGEs. Oblasts', Kyiv and Sevastopol state administrations are subordinated and accountable to the central executive organs. Rayons' state administrations are subordinated and accountable to the oblasts' state administrations. Heads of the local state administrations are appointed and dismissed by the President. Oblasts' and rayons' state administrations are partially accountable to oblasts' or rayons' councils within the functions delegated by councils to administrations.

Villages', settlements' and towns' councils are subordinated neither to each other nor to the central bodies. However, councils of villages, settlements and towns of rayon importance have to coordinate their activity with rayon councils when it concerns implementation of joint programs (for given rayon); similarly councils of rayons and cities of oblasts' importance have to coordinate their activity with oblasts councils concerning joint programs.

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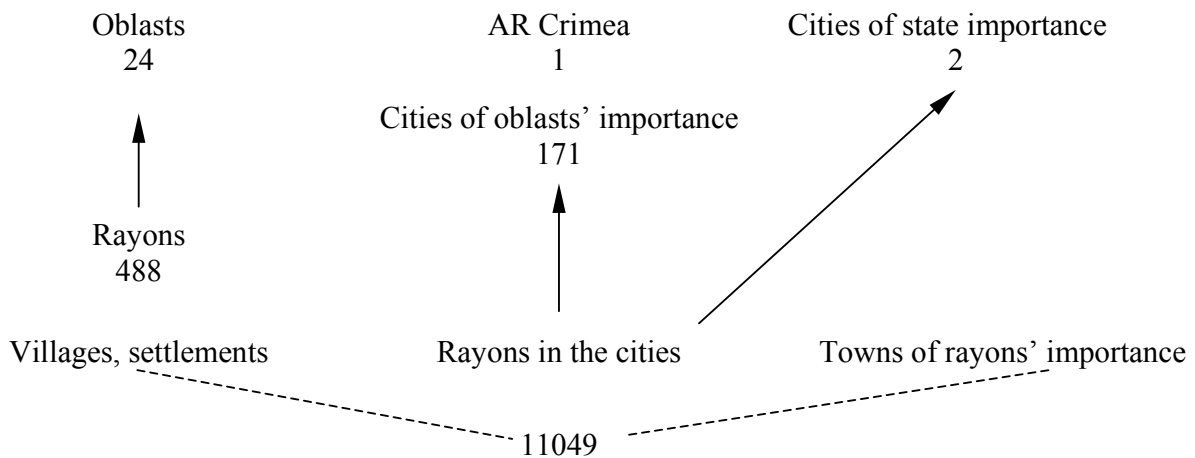
<sup>30</sup> Kyiv and Sevastopol are the only cities in Ukraine that have so called state importance, other cities and towns have oblast's or rayon's importance.



Local self-governance is ensured in Ukraine by the Constitution (Art. 7), and its rights are protected by courts (Art. 145). Central government bodies are prohibited to intervene in the activity of LGE's that concerns fulfillment of their own responsibilities (Law on Local self-governance, Art. 20). Number of LGEs of different levels is shown in Picture 1.

Public tasks of LGEs are divided into own responsibilities and delegated responsibilities. *Own responsibilities* include tasks of local importance that ensure implementation of rights and obligations of local self-governance determined by Ukrainian Laws. *Delegated responsibilities* include tasks that are determined by the State and transferred to local bodies of self-governance according to subsidiarity principle (Art. 82 of the Budget Code). LGEs are responsible for the provision of certain services in the spheres of education, health care, culture and sports, administration, social protection and social security, transport and roads, environment protection (for details see Annex 1). Some organizational issues are defined in the Law on local self-governance (responsibilities of LGE's for preparation of the social-economic programs, budget formulation, management of communal property, etc.). Functions and relevant expenditures of LGEs of different levels are defined by the Budget Code.

LGE's activities are not clearly distinguished from that of the other entities of public and private sector. For example, concrete responsibilities of LGEs' within a given area (education, health care, culture, etc.) as compared to private sector activity are not defined.



**Picture 1. System of LGEs in Ukraine (in brackets: quantity of entities)**

Besides, the division of functions across the different levels of government is not completely clear and some functions are overlapping. For example, responsibilities for pre-school education and general secondary education are assigned both to towns, villages, and to rayons. Primary medical and sanitary aid, out-patient and in-patient aid are defined as functions of towns (villages), rayons and oblasts. Specialized medical and sanitary aid is assigned both to oblast level and to State level. Both rayons and oblasts LGEs are responsible for the development of the physical culture and sports (for details see Annex 1). Unclear division of functions produces conflicts with respect to distribution of finance across LGEs of different levels.



The main field of jurisdictional dispute between LGEs and state administration is financing of social benefits. Recipients, types and size of social benefits are determined by central government. However, financing of the social benefits is assigned to local budgets. In practice, local budgets often lack necessary resources and accumulate huge budgetary arrears (the so called problem of unfunded social mandates). Since 2001, in the course of budgetary reform (implemented with a Budget Code) central government has taken financing of the main part of social benefits under its own responsibility. Currently, children benefits, benefits for disabled and veterans of war and labor, housing (income) subsidies<sup>31</sup> and transport subsidies for privileged categories of population are financed by transfers from central budget.

**Creation, consolidation, division and liquidation of LGEs** is decided by Verkhovna Rada. Administrative-territorial network is determined by Ukrainian Laws. Every administrative-territorial unit has a council (elected by residents), executive board (established by council) and state administration (for oblasts and rayons). LGEs don't have the authority to change current administrative-territorial system, though they can submit relevant proposals to Verkhovna Rada. Cities with rayons division constitute the only exception. Here, city councils have the power to create, liquidate and consolidate rayons within the city. In addition, some villages and settlements can be consolidated and elect a single council. Consolidation decision needs to be approved in local referenda (Art. 6 of the Law on Local Self-Governance).

Local councils can adopt the statute of territorial community (Art. 19 of the Law on Local Self-Governance). However, such statutes are not obligatory for LGEs. Organizational issues to be covered by LGE's statutes are not prescribed. All statutes are to be registered in the Ministry of Justice that controls their compatibility with Ukrainian Laws.

Local councils are composed of deputies. Deputies are to be elected by residents every 4 years during the countrywide elections. Heads of the villages', settlements' and towns' councils and their executive boards are elected by the residents. Heads of oblast and rayon councils are elected by the deputies of these councils. Election procedures are clearly defined by Ukrainian Constitution and the Law on Local Self-Governance. If local council doesn't function properly, local referenda can decide on the dismissal of the relevant council. After referenda, Verkhovna Rada fixes the date of the new election to local council (Art. 78 of the Law on Local Self-Governance).

After election, every council appoints its executive board. Boards are subordinated and accountable to councils. Members of the executive boards are proposed by the heads of the councils and need to be approved by councils. Executive boards of the local councils function until the next election and appointment of the new council.

Local councils are able to set up special departments, sections and other executive units for fulfillment the tasks under responsibility of the relevant councils (Art. 54 of the Law on Local Self-Governance). These departments, sections and other executive units are accountable to the councils and subordinated to the executive boards. Heads of the departments, sections and other executive units are appointed and dismissed by the heads of the councils. Before 2000, LGEs were allowed to create extra-budgetary funds. They did it on a large scale and used extra-budgetary funds to carry out financial transactions beyond the control of the central government and public.

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<sup>31</sup> Price subsidies for housing and communal amenities in Ukraine have been abolished since 1997.



Since 2000, directives of the central government prohibit LGEs to have any extra-budgetary transactions and require every revenue and expenditure item of LGEs to be included into the local budget. Revenues and expenditures of LGEs that are not directly related to public revenues and budgetary appropriations must be shown as a "special fund" of local budget. *Special funds* can be created on the basis of the following sources:

- *Revenues earmarked to special categories of expenditures* (e.g. obligatory contributions to the Fund for social protection of disabled are directed toward special programs of support for the disabled people.
- *Income from commercial activity of the budgetary agencies* (e.g. fees for medical services in public hospitals, tuition fees in the universities and so on). Budgetary agencies can earn income and spend it on their own needs beyond the control of fiscal authority. Total sum of income and respective expenditures should be shown in local budget.
- *Charitable contributions of the enterprises that are under the jurisdiction of LGEs*. Relevant revenues and expenditures are not planned in the budget, but if enterprises donate some money (voluntarily, or as it often happens, in the exchange for certain commercial privileges) they appear in the budget as "special fund".

Official data does not allow to distinguish between 3 types of special funds. In 2002, special funds amounted to UAH 3.37 m and constituted 13.6% of the total expenditures (UAH 24.7 m).

Executive boards of the village's, settlement's and town's councils are empowered to prepare the draft of relevant budget, submit it to the councils for consideration, implement approved budget and report quarterly on budget execution (Art. 28 of the Law on Local Self-Governance). Rayons', oblasts' and cities' (in Kyiv, Sevastopol) state administrations are responsible for relevant budget planning and execution, and reporting on budget execution (Art. 119 of the Constitution).

In course of the first week after the approval of State budget in the second reading, Cabinet of Ministers informs local state administrations and executive boards of the local councils about the indicators of intergovernmental fiscal transfers. Then, local state administrations and executive boards of the local councils prepare the drafts of the relevant budgets. Local budgets are considered and approved by the councils that are free to decide on the size and structure of their budgets within the provisions of State Budgets related to intergovernmental fiscal transfers. Oblasts', rayons' towns' budgets are to be approved not later than 2 weeks after official publication of the Law on State Budget. Budgets of a lower level (towns of rayon importance, rayons in the cities, villages and settlements) are to be approved during 2 weeks after the adoption of the budgets of a higher level (rayons and cities).

Local fiscal organs may initiate decision on local budget revision if revenue side is under- or overexecuted (compared to plan). Decision on budget revision should be adopted by a relevant council. Local councils are free to decide on the amounts of borrowing and debt repayment, but within the limits set up by Budget Code.

Local fiscal organs (special departments of the executive boards) organize and manage budget execution. Currently, local budgets undergo the process of transition



to Treasury execution<sup>32</sup>. Although local budgets are considered to be independent, treasury functions have to be fulfilled by the local departments of State Treasury, i. e. coordinated from the Center. Quarterly and annual reports on local budget execution are prepared by the local departments of State Treasury that submit these reports to the executive boards of the local councils.

Central government may *delegate some responsibilities* to LGEs. In this case, it is obliged to transfer financial resources that are sufficient to carry out duties imposed. Appropriate funds are to be envisioned in the Budget Law in the form of Central Budget transfers. However, legal provisions and actual practice differ significantly. During the last decade, many public functions have been transferred to the local level, while at the same time revenue base of local budgets has narrowed. LGE's adjusted to this situation in the following way:

- Some budgetary agencies have been closed and their staff curtailed;
- Budgetary allocations covered only wage bills, social benefits, etc.; expenditures for materials, repairs, heating, gas were missing in local budgets;
- LGEs accumulated budgetary arrears, which has been offset by tax arrears or cancelled by the decision of Central Government.

Local budget expenditures are divided into 2 parts: 1) expenses on functions of local self-governance that have local importance (own responsibilities of LGEs); 2) expenses on public functions transferred to LGE's in accordance with subsidiary principle (delegated responsibilities). If revenues assigned to local budgets don't cover expenditures on delegated responsibilities (estimated on the basis of special norms), the gap is closed via Central Budget transfers.

According to the Constitution, Law on Local Self-Governance, and Budget Code, LGE's are assigned with special responsibilities that are fulfilled via participation in commercial activity or budgetary financing of the specified units and programs. According to the Law on Local Self-Governance, local councils are responsible for management of housing and communal amenities, transport, communication and other enterprises owned by municipalities, and quality of the products supplied by these enterprises. Municipal enterprises are accountable to local council, which appoints their directors. However, these enterprises are independent in their commercial activity. Local councils are free to decide whether to privatize certain enterprises or keep them in municipal property. At the same time, the fulfillment of public tasks has to be ensured. In case of privatization, private companies sign a special agreement with LGEs that fix commitments of the private suppliers. LGEs commission their tasks to private entities via licensing and controlling the quantity and quality of products (services) supplied. Any private firm that fulfills certain criteria established by LGEs may apply for the license. Preferences are given to the firms with good capital endowment, skilled personal, etc. Firms that are allowed operating at a given market are subject to control of LGEs<sup>33</sup>. In some cases, prices for the products/services are approved by LGEs.

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<sup>32</sup> Earlier, accounts of the local budgets have been serviced by commercial banks.

<sup>33</sup> In regard to transport companies control covers transport routes, schedule of the transportation, technical security of the passengers, etc.



The scope of LGEs budgets is presented in Table 5.1. All financial activities of LGEs are included into the budget. However, 13.6% of total resources is beyond the control of financial departments, they are comprised in a special fund of the budget.

**Table 5.1 Main indicators of the local budgets in 1998-2002 as % of GDP**

	1998	1999	2000	2001	2002
Local budget revenues before transfers from the Central budget*	12.9	10.3	7.7	8.1	8.8
Local budget revenues after transfers from the Central budget*	15.0	12.7	10.2	11.7	12.8
Local budget expenditures before transfers to the Central budget*	14.6	12.4	9.2	10.4	11.2
Local budget expenditures after transfers to the Central budget*	15.2	12.6	10.0	11.7	12.5
Central budget transfers to the local budgets	2.1	2.3	2.5	3.6	4.0
Net transfers from the Central budget	1.6	2.1	1.7	2.3	2.7

Source: IER calculations, based on the data of State Treasury, Ministry of Finance and State Statistics Committee.

\* For data comparability own funds of budgetary agencies are excluded.

LGEs are responsible for the development of housing and communal amenities, local transport, road construction and maintenance (Budget Code of Ukraine). In 2001, total local budget expenditures equaled UAH 24.89 bn, where UAH 3.27 bn represented capital expenditures. The structure of *capital expenditures* of LGEs is the following:

- UAH 454.8 m – purchase of the equipment and durable goods;
- UAH 236.4 m– housing construction;
- UAH 1100 m - construction of the commercial entities;
- UAH 973.2 m– construction of the social-cultural net;
- UAH 682.7 m– capital repair;
- UAH 895.3 m– capital transfers.

Capital expenditures of LGEs are comparable with those of Central Government. In 2001, Central Budget allocated UAH 3.29 bn for capital expenses.

Public services carried out by LGEs include:

- 1) free services (education, health care, culture, sports, public administration) that are financed by relevant budgetary agencies in accordance with the spending plan (koshtoris vytrat),
- 2) paid services (transport, gas, water supply, heating, water sanitation, etc) provided by commercial entities , i.e. municipal enterprises or private companies that are regulated by LGEs

Main indicators of LGE's enterprises activities are presented in Table 5.2.

**Table 5.2: Indicators of LGE's entrepreneurship in 2001, m UAH**

	Enterprises of all kinds of property	Municipal enterprises	Municipal enterprises in % of total
Number of enterprises	265597	8840	3.3
Value of fixed assets	393436.6	101738.5	25.9
Sales	683090.4	9524.1	1.4
Net profits	12315.4	-499.6	-

Source: State Statistics Committee of Ukraine.

Budget revenues are divided into tax and non-tax revenues, revenues from capital transactions, and transfers. Expenditures are classified across the functions, economic transactions, main distributors of budgetary funds and budgetary programs. Economic classification contains the following categories: current expenditures, capital expenditures, net credits (credits minus repayment). The categories of functional classification of expenditures include general state functions, defense, public order, security and justice, economic activity, environment protection, housing and communal amenities, health care, culture, sports, education, social protection. Budget deficit financing is classified by type of creditors and obligations. Similar principles of classification are applied to the special fund of budget. Same classification is applied both to Central and local budgets.

Budget transactions are recorded on cash basis.

## 5.2. The LGEs revenue

Data on revenues of LGEs in 1998-2002 is presented in Table 5.1. In 2001, LGEs' revenues constituted 30% of the total public revenues (including social insurance system).

Budget Code of Ukraine and Decree of the Cabinet of Ministers "On Local Taxes and Fees" regulate the issues related to LGEs revenues. Art. 7 of the Budget Code declares that local budgets are independent, their independency is ensured by the assignment of certain revenue sources and the authority to spend the funds.

However, current system of inter-governmental fiscal relations in Ukraine makes LGEs dependent on the Center. Budget revenues assigned to LGEs by Central Government are scarce and a significant part of local budgets expenditures is financed via Central budget transfers. LGEs are deprived the authority to establish tax rates and define the tax base for almost all taxes, except of some minor local taxes and fees.

Revenue sources that are assigned to LGEs have to ensure the fulfillment of their own responsibilities as well as delegated responsibilities. Own revenues have to cover all expenditures related to own responsibilities of LGEs. Revenues assigned to delegated responsibilities cover relevant expenditures only partially, and the gap is to be closed by transfers from the Central Budget. The Ministry of Finance estimates revenues and expenditures of LGEs for delegated responsibilities in the process of budget preparation and defines the amount of transfers to cover the gap.

Present legislation regulates distribution of transfers across the different levels of government only down to the rayon level. Distribution of transfers between the towns of rayon importance, villages and settlements is subject to a decision of rayons' councils.





*The sources of LGEs' own revenues* (taxes assigned for fulfillment of LGE's own responsibilities) include the following:

- Local taxes and fees
- Land fee
- Tax on the owners of vehicles
- Interests for the budgetary funds deposits
- Dividends on the shares owned by municipalities
- Fee for the environment pollution
- Ratio of the Fixed agricultural tax
- Rent fee on municipal property
- Profit tax on the enterprises owned by municipalities

Local taxes and fees are regulated by the Law "On Taxation System" (alongside with state taxes) and the Decree of CMU "On the Local Taxes and Fees", which define their list and establish the limits for tax rates. LGEs are authorized to establish local taxes and fees within the list stipulated by Law and determine the tax rates within the limits prescribed by Decree. Tax on advertisement, communal tax, fee on oversea tourism, hotel fee, market fee, fee for the placement of trade objects are obligatory taxes that are collected by LGEs (Art. 2 of the Presidential Decree). Imposition of other local taxes and fees within the list is decided by LGEs.

Local taxes and fees represent the only source of own revenues for LGEs. An insignificant share of local taxes and fees in the revenues of local budgets (see Table 5.3.) invalidates the cost-benefit principle in the sphere of intergovernmental fiscal relations in Ukraine.

Data on the share of local taxes and fees in total revenues of LGEs in 1998 is presented in Table 5.3.<sup>34</sup> Local taxes and fees constituted 0.41% of total revenues (without transfers from the central budget) for oblasts budgets, 5.8% - for cities of oblast importance, 2.4% - for rayons, 15.66% - for cities of rayon importance, 16.41%- for settlements, and 5.94% - for villages. Average respective share for LGEs of all levels equaled 2.97. The shares of local taxes and fees in total revenues of local budgets including transfers are even lower (0.3%, 4.56%, 1.11%, 12.64%, 11.55%, 3.32% and 2.04% respectively).

Tax exemptions are decided by Verkhovna Rada and local councils. However, local councils are empowered to exempt enterprises only from those taxes that are collected on the local level and come directly to their own budgets. These taxes include both local taxes and fees and state taxes assigned to local budgets. Regulations do not guarantee equal treatment of all taxpayers on the local level.

In order to ensure fulfillment of delegated responsibilities, central government assigns to LGEs the following taxes:

- Personal income tax
- State duty

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<sup>34</sup> Data for 1999-2002 is not available.



- Fee for the licenses on entrepreneurial activity
- Fee for the registration of the business agents
- Fee for the trade patent
- Unified tax for small businesses
- Administrative penalties and sanctions imposed by LGEs.

Rayons and oblasts budgets participate in personal income tax and land fee in line with the ratios established by Budget Code.

**Table 5.3.: Local taxes and fees by levels of government in 1998**

	Oblasts, AR Crimea, c. Kyiv, Sevastopol	Cities of oblasts importance	Rayons	Cities of rayons importance	Settle- ments	Villa- ges	LGEs total
<i>% of total revenues without transfers</i>							
Taxes (on advertise- ment, communal tax)	0.07	2.73	1.26	8.72	7.92	3.19	1.39
Fees	0.34	3.07	1.14	6.94	8.49	2.75	1.58
Total local taxes&fees	0.41	5.80	2.40	15.66	16.41	5.94	2.97
<i>% of total revenues including transfers</i>							
Taxes (on advertisement, communal tax)	0.05	2.15	0.58	7.04	5.58	1.78	0.95
Fees	0.25	2.41	0.53	5.60	5.98	1.54	1.09
Total local taxes&fees	0.30	4.56	1.11	12.64	11.55	3.32	2.04

Source: IER calculation based on the data of the Finance Ministry.

LGEs manage property, which they own. LGEs receive dividends on shares in joint stock companies with LGEs' holdings. Ukrainian legislation grants LGEs the right to dispose a certain part of profit of non-corporatized enterprises owned by LGEs. Revenues from property are collected by LGEs, the process of collection is not subject to central regulation.

Property owned by LGEs has not been evaluated according to the market criteria so far. Fixed assets are evaluated according to the bookkeeping standards. At the end of 2001, residual value<sup>35</sup> of the total fixed assets of the enterprises of all forms of ownership constituted 393.4 bn UAH, including 205.9 bn UAH concentrated in public sector. Fixed assets of municipal enterprises amounted to 101.7 bn UAH constituting 49.4% of public sector assets. Data on fixed assets of budgetary agencies is collected by Treasury and for the last several years has not been disclosed. In 2001, revenue from property constituted 2.5% of total local budgets revenues (privatization receipts contributed 2% p. to above ratio)

LGEs receive financing from central budget in the form of equalization and conditional transfers. Budget Law for 2003 determines the following amounts of transfers:

- Equalization transfers from Central Budget to local budgets – UAH 5,423 m;
- Equalization transfers from the local budgets to Central Budget – UAH 2,399 m;
- Conditional transfers from Central Budget for social programs – UAH 4,509 m;

<sup>35</sup> Residual value is primary value minus depreciation



- Conditional transfers from Central Budget for investment programs – UAH 240 m;
- Other conditional transfers from the Central Budget for different purposes – UAH 105.9 m.

Equalization transfers are expected to cover the gap between the revenues assigned to the fulfillment of delegated responsibilities by LGEs, on the one hand, and expected expenditures related to these tasks, on the other hand. In order to account for different transition difficulties (related to introduction of the formula-based approach) and provide incentives for LGEs in raising the revenues/cutting the expenditures, formulas for calculation of equalization transfers contains different “correction coefficients”.

The Ministry of Finance calculates equalization transfers across the different functional expenditures (e.g. for governance, education, health care, etc.) and for every LGE down to rayon level. For a given LGE, all “functional” transfers form a general transfer fund. Central authority doesn’t control the compliance of actual dimensions of expenditures financed via equalization transfers with the original purposes. LGEs are free to allocate these funds for any tasks in line with the decisions of the local councils.

Equalization transfers come from the State budget in the following way: every day taxes collected to the accounts of oblasts departments of State Treasury are shared between the state budget and local budgets in accordance with the ratios approved in Budget Law. Funds disposed by local budgets are accounted as transfers from the state budget. Revenues of state budget subjected to sharing in the form of transfers include enterprise profit tax, fees for the natural resources utilization, VAT, excise for domestic goods, fee for the licenses.

Alongside with the equalization transfers, Budget Law envisions conditional transfers for investments and specific social programs (to ensure equal social standards throughout the country).

The cost calculation for equalization transfers from the Center is missing. Everything depends on the value of funds available to the Government. The Ministry of Finance estimates expenditures of LGEs on delegated responsibilities on the basis of “budget sufficiency norms”. However, “budget sufficiency norms” have nothing to do with the costs of public services provision. Art. 94 of the Budget Code stipulates that budget sufficiency norms are used for distribution of the intergovernmental fiscal transfers and such norms are defined as ratio of the total budgetary funds allocated for specific program to the number of residents or consumers.

Conditional transfers for social programs are calculated as a product of the number of beneficiaries (residents of given territory) and respective norms established by Ukrainian Laws (e.g. 58 UAH as a benefit per 1 child, 80 UAH as direct assistance to low-income households per family). Such norms have nothing to do with the real costs of living: official minimum subsistence level is 380 UAH. The amounts of different social benefits are determined every year basing on the forecasted level of budget revenues.

Conditional investment transfers are distributed according to political preferences: strong regions (in political sense) receive more than weak ones.

Conditional and equalization transfers together constituted 44% of local budgets revenues (without transfers) in 2001, and 45%- in 2002.



The Budget Code regulates the issues of deficit, borrowing and debt of LGEs:

- The limit of debt of Crimea AR or local self-governments as well as the limit of granting state guarantees shall be established for each budget period by making the decision on local budget (Art. 18).
- The budget of Crimea AR and budgets of the towns may be adopted with deficit only in the part of the development budget (Budget Code of Ukraine, Art. 72). Loans to the relevant budgets may be made only to the development budget (Art. 74).
- The budgets of oblasts, rayons, districts (in cities), settlements and villages cannot be approved with deficit (Art. 72).
- Only Verkhovna Rada of Crimea AR and city councils (Radasy) are entitled to make domestic loans. External loans can be made only by city councils of the cities with the population above 800 thousand inhabitants according to the state statistics official data at the time of approval of the respective decision (Art. 16).
- In order to cover temporary shortage of cash during the implementation of general fund of local budget, Council of Ministers of Crimea AR, local state administrations and executive bodies of relevant councils are allowed to receive short-term loans from financial and credit institutions with a maturity not exceeding three months, and only within the current budget period (Art. 73).
- Annual expenditures for servicing of the debts of local budgets should not exceed 10% of the expenditures from the general fund of the corresponding local budget (Art. 74).
- If the schedule of loan repayment is violated by the borrower in the process of repayment of debt principal or its servicing, the corresponding council should not make any new loans during the following 5 years (Art. 74).
- The central government assumes no responsibility for the loans to local budgets (Budget Code of Ukraine, Art. 74).

*Financial assets* of LGEs are divided into *short-, medium- and long-term*. Before 1998, LGEs issued domestic bonds, but after financial crisis this source of financing was terminated. Therefore now LGEs use short-term bank borrowings to cover the cash gaps. Due to the Lack of borrowing funds and strict regulations of the central government majority of LGEs' budgets are balanced.

Data on LGEs' debt is not available for general public.

Ukrainian legislation doesn't restrain development of the bond market for LGEs. However, a lack of confidence in LGEs' fiscal sustainability, undeveloped financial infrastructure and scarce domestic capital make this market weak and fragile.

According to accounting standards, international aid is to be recorded in "official transfers" – the last item of the budget revenues classification. However, in reality, international aid is not granted to LGEs in Ukraine. IBRD and EBRD finance some projects on modernization of local infrastructure on commercial terms. These loans are treated as local budgets deficit financing in the part of special fund; at the same time, they are recorded as lending of LGEs to enterprises – recipients of the foreign loans.



### 5.3. Financial guaranties for LGEs

Budget Code fixes revenue sources assigned to LGEs for a fulfillment of the own as well as delegated responsibilities. The state guarantees the availability of certain tax revenues for LGEs. However, discrepancies between the actual revenues and legal obligations of LGEs are high. The Constitution doesn't contain appropriate regulation. It only declares "the state participates in the forming of local budgets revenues and supports local self-governance financially" (Art. 142).

Both own and delegated responsibilities of LGEs are not backed with sufficient sources of revenues. Revenues assigned to LGEs by Budget Code for the fulfillment of their own responsibilities amount to 1% of GDP. Revenues assigned to delegated responsibilities constitute 6-7% of GDP. Nobody estimates actual costs of obligations imposed on LGEs by the Center, since budgetary planning has always relied on the forecast of "available budgetary funds" rather than real costs of public services. Anecdotal evidence shows that:

- LGEs always complain about the lack of funds for financing their own and commissioned tasks.<sup>36</sup>
- Before a new system of tax assignment has been introduced, revenues of the local budgets accounted for 10.3-12.9% of GDP, and LGEs accumulated huge budgetary arrears (since then there was no significant redistribution of the expenditure responsibilities across the governments of different levels)
- For several years, LGEs planned expenditures for gas, water, electricity consumption for budgetary units at the level of 30-40% of the real costs.
- From time to time central government obliges LGEs to finance some tasks without transferring additional funds to local budgets. E.g. in 2002, local budgets suffered from the lack of funds for financing free consumption of housing and communal services by selected households (privileges were granted by central government).

Thus the Center fails to provide LGEs with financial recourses sufficient to fulfill their delegated responsibilities. On the other hand, control over the execution of delegated responsibilities by LGEs is absent. No regular procedures and mechanisms for control are incorporated in the fiscal activity of the Central Government. Misallocation of the central budget transfers (provided to cover delegated responsibilities) by LGEs is quite common.

General approach to distribution of the funds between the center and regions as well as between LGEs is quite clear. However, application of different coefficients to the calculation of transfers from Central Budget seems to be problematic.

Mechanisms of financial alignments regarding LGEs are established by the Budget Code and the Resolution of CMU concerning transfers distribution (N1382, 2002). The procedure for transfers calculation seems to be clear and easy to understand - Transfer (T) equals the difference between estimated expenditures on delegated responsibilities (E) and estimated revenues assigned to LGEs for delegated expenditures (R) multiplied by equalization coefficient. However, this approach creates several problems:

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<sup>36</sup> See: I. Нагребецька. Баланс повноважень – баланс ресурсів // Урядовий кур'єр, 15 жовтня 2002 р., №190.



- Variable R is declared to be "tax capacity indicator", although it is calculated as weighted average of the actual tax collection for previous 3 years; so it reflects different tax-raising efforts undertaken by LGEs in the past and provide no incentives for LGEs to collect more.
- Variable E is declared to be based on the "budget sufficiency norms", although it is calculated as total budgetary fund arbitrarily distributed across different expenditure programs and divided by the number of residents or consumers of every program; thus no costs accounting or other objective criteria are incorporated in the planning of budget expenditures.
- Since 2003, CMU has introduced special "depressivity coefficients" for R estimation; these coefficients take 4 values which are arbitrarily applied to different LGEs; thus there is equal treatment of LGEs, and success of the region in intergovernmental fiscal relations depends on the ability to prove its "depressivity".
- Formula elaborated by CMU for estimation of E contains numerous "correction coefficients". Both methods of their calculation and criteria of application to certain LGEs are unclear; this again violates the principle of equal treatment, since the success of the region depends on the ability to bargain for more favorable "correction coefficient".

In the course of the year, the amounts of planned transfers to LGEs' budgets might change (though not often). In 2002, planned transfers have been changed only once. According to the Law (26.12.02), central budget transfers for covering consumption of gas, electricity, heating and water by privileged groups of population are to be increased by the difference between the price of appropriate services and their costs. The sum of increase is not stipulated, and financing of additional central budget expenditure should be covered repayment of tax arrears by the state-owned company "Naftogas Ukrainy". The main reasons for changes in transfer are price rigidities for the services supplied by the state-owned companies and regular revisions of the minimum wage in budget sector.<sup>37</sup> Changes in transfers undermine fiscal planning of LGEs and eliminate incentives for proper execution of the delegated responsibilities.

#### **5.4. The scope and procedures of the state supervision of LGEs' activity**

In regard to fiscal affair, the LGEs' supervisors are represented by

- Local state administrations of the upper level
- Ministry of Finance
- Regional departments of the State Treasury
- State Control and Auditing Agency
- Accounting Chamber of Ukraine.

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<sup>37</sup> In Ukraine revision of the min wage is not regulated by law, but politically determined. Budget is planned on the ground of min wage stipulated by relevant Law. However, sometimes, after budget was approved, Verkhovna Rada declares new amount of min wage, amends special law and obliges CMU to finance the wage bills in line with new law. In this case the amendments to the Budget Law are prepared and amount of initially planned transfers to LGEs are changed.



Supervisors' competence doesn't violate the principle of self-governance. On the contrary, LGEs are given much freedom. Though the major part of local budgets represent delegated responsibilities, no state agency is explicitly responsible for controlling LGEs' budgets.

Local state administrations are subordinated and accountable to the state executive bodies. Thus, supervisors of the local administrations are ministries and administrations of the upper level. However, competence of local administrations is limited to the rayons and oblasts budgets that cover joint programs of the towns, villages and settlements.

Other LGEs (local councils and their executive boards) are independent and can freely dispose local budget funds.

Ministry of Finance is empowered to control the implementation of the budget laws at all stages of the budgetary process both at the central and local levels. However, the authority of the Ministry of Finance in regard to LGEs is not clearly defined and, in fact, directives of the Ministry are not obligatory for the local self-governance bodies. Any time they can refer to the Art. 20 of the Law "On Local Self-Governance", which states that officials of the central power bodies are prohibited to intervene in the activity of LGEs'.

Accounting Chamber controls fiscal activity of the local state administration (oblasts' and rayons') and fulfillment of the delegated responsibilities by LGEs. However, the main function of Accounting Chamber is to control expenditures of the state budget. It seems to be difficult due to a limited staff (app. 200 employees). Therefore, checks at the local level, accomplished by Accounting Chamber, are rare.

In reality, State Control and Auditing Agency is the only agency that in some cases and to some extent controls fiscal transactions of LGEs'. However, checks conducted by State Control and Auditing Agency are not regular and concentrate on the level of budgetary agencies. This Agency is obliged to control every budgetary institution, at least, every 4 years, but no commitment is fixed in regard to the local budgets.

Since 2002, Treasury transactions are extended towards the local budgets. But Treasury control is rather technical and limited to budget execution stage. Every payment of the budgetary agency has to be authorized by the Treasury that controls the compliance of payment with the budget appropriation.

Delegated responsibilities of LGEs are controlled only at the stage of budget preparation. Cabinet of Ministers is empowered to control the fulfillment of delegated responsibilities by oblasts budgets, and budgets of Kyiv and Sevastopol. In case of violations, Cabinet of Ministers is able to cancel the decision of the relevant LGE and initiate court proceedings against oblasts' state administration.

Within 1 month after the approval of the rayons' and towns' budgets, oblasts' state administrations have to control their compliance with the requirements concerning delegated responsibilities. If some violations are discovered, oblast state administration is able to cancel the decision of the relevant LGE and initiate court proceedings against rayon's state administration or town's council.

Similarly, within 1 month after the approval of the towns' and villages' budgets, rayons' state administrations have to control their compliance with delegated responsibilities. If some violations are discovered, rayon's state administration cancels the decision of the relevant LGE and initiate court proceedings.



If violations of budget laws have been discovered, Ministry of Finance, State Treasury, State Control and Audit Agency, local executive boards, local financial organs are authorized to take the following actions:

- To stop budgetary transactions (terminate budgetary allocations),
- To impose sanctions on the persons responsible for violations.

Misuse of funds (spending for the purposes which are not stipulated in budget law) leads to cutting of budgetary appropriations by the amount of misused funds and criminal or administrative punishment of the responsible persons.

Violation of the budget law is documented by the Act of revision or Protocol on budgetary infraction. Minister of Finance, Head of the State Treasury, State Control and Audit Agency, heads of the local financial organs are authorized to make the decision concerning budgetary infraction and punishment of responsible persons.

If LGE budget was not enacted in time, the supervisor is not authorized to take any actions. Art. 79 of the Budget Code stipulates that in case local budget is not adopted in time, local state administrations and executive boards of the local councils are allowed to spend funds only for the purposes, prescribed by previous budget law. Capital expenditures are prohibited until new budget for the current year is approved. Monthly current expenditures cannot exceed 1/12 of those approved for the previous year.

## **5.5. Openness of LGEs' finance.**

Free access of the citizens to information is declared to be the main principle of the state information policy (Art. 6 of the Law "On Information"). According to Art. 9, all citizens of Ukraine have the right to receive, use, disseminate and store the data that is necessary for fulfillment of their functions and implementation of their rights.

Central and local government entities are obliged to:

- Disclose information on their activity
- Publish statistical data regularly
- Provide public access to unpublished statistical data (if dissemination of this data is not limited by law)
- Maintain special databases with a free access by citizens
- Establish and update official web pages with the data on activity of the relevant entities, implementations of the programs, normative and legislative acts.

Presidential Decree, dated of 02.08.2002, declares openness of economic and social policy as a priority of the central and local governments.

Territorial community is empowered to hold public hearings – to meet with the deputies of the local councils and the members of the executive boards, ask questions and make proposals. Public hearings are to be organized, at least, once a year. Local self-governance organs are accountable to the territorial communities. These organs are obliged to inform the residents bi-annually about the implementation of the programs of social and economic development, local budget issues etc. (Art.75 of the Law on Local Self-Governance).





Written requests by citizens concerning the provision of unpublished data are to be considered by LGEs within 1 month (sometimes 45 day).

According to legislation, LGE can deny the access to information if it is recognized by law as restricted information. In this case, LGE is obliged to send a special notification to a requester and refer to the provision of law that limits public access to information.

Primary data collected by the state statistical organizations from the enterprises and administrative bodies is considered to be confidential and closed for public (Law on State Statistics). This data can be used only in the aggregated, impersonal form.

According to the Law on Information, public access to information may be limited in the following cases:

- Information is recognized to be a state secret;
- Information is confidential;
- Information is related to the investigations carried out by police, court, etc.;
- Information is related to private life of the citizens;
- Administrative documents are intended for internal circulation and preparation of the final decision that have the official form;
- Information of the financial institutions is prepared for the control and audit agencies.

State Statistics Committee is obliged to disclose statistical information and publish special bulletins, press-releases etc. in accordance with a plan. Public access to statistical information collected in accordance with the plan of state statistical survey, is free of charge. Additional data (outside the scope of state plan) can be obtained on a contract basis. Statistical and other administrative bodies may also ask the fee for the preparation of copies of the requested documents. However, search for the requested documents and data itself are free of charge.

In reality, LGEs often violate the legislative provisions and limit access to information that should be publicly available. In such cases, officials of LGEs use excuses like "information is not available temporarily", "requested data has not been collected yet", "data can not be disseminated because of the technical difficulties".

Sometimes, LGEs' reports on relevant issues are published in the local newspapers, but they are not regular. LGEs are required by Ukrainian legislation to maintain their own web pages. However, there is no requirements concerning the content of these pages, and nobody supervises the quality and quantity of information presented. 3 LGEs (Zhitomyr, Rivne oblasts' administrations and Sevastopol City's administration) of the highest level out of 27 do not have own web pages. Majority of LGEs present rather scarce information at their web pages – some statistical indicators, reports on regional economic development, and recent legislative acts adopted by oblasts' administrations or oblasts' councils. Crimean, Ivano-Frankivsk, Volynsk and Kharkiv oblasts state administrations are the exceptions: quality of their web pages is rather high.

Existing web pages belong exclusively to the oblasts state administrations (plus Crimea and Kyiv); only few of them contain information about oblasts or cities councils; LGEs of the rayon level don't have web pages at all. This situation is explained by the fact that central government obliges oblasts state administrations to



declare government policy and disclose some statistical data via Internet. Local self-governance bodies (that are independent) don't feel themselves to be obliged to provide free access to information.

*Project of Budget.* Citizens do not have access to LGEs budget debates. Though they are able to meet their deputies (members of the local councils) or employees of the executive boards and to make proposals related to local budgets, as a rule, these proposals are not accounted for in the draft budgets. Out of 27 LGEs of the highest level, only one (that one of AR Crimea) has the page that contained some parameters of the draft budget for 2003. However, the available information was limited to 1 page with some figures and explanations to the draft budget.

*LGEs financial data.* This data is incomplete and reported by a few LGEs. Even those who report, present only the data on budget execution, data on profits earned by enterprises located in certain territory, and data on these enterprises' payables and receivables.

*Budget execution.* Out of 24 oblasts and AR only 8 reported on budget execution at their web pages. The quality of information leaves much to be desired. Sometimes, the scope of the reports is limited to the revenue part or total amounts of local budget revenue and expenditure; sometimes, reports are presented in the form of comments with a few figures. Treasury prepares reports on local budgets' revenues and expenditures with aggregate figures for Ukraine. These reports are prepared on a monthly basis and are available to the public. Quarterly reports with additional data are not disclosed.

*Resolutions implemented.* LGEs are required to disclose their normative acts, official decisions and report on their activities. They present relevant information on the official web pages and local newspapers.

*LGEs' property.* The list of municipal enterprises managed by relevant LGEs is the only information available to public on LGEs' property. But even this scarce data is rarely presented in the web pages. Only 7 LGEs disclose information on the municipal enterprises at their web pages. Regional departments of the State Statistics Committee compile the data on the enterprises of all types of ownership, but municipal enterprises are not distinguished from all others. Citizens do not have access to the initial data, and can only look at the aggregates for Ukraine

Data on the functions of the municipal enterprises, their fixed assets and working capital, performance and profitability is not mentioned at all. Only 1 LGE's web page (Crimean) informs about the total value of fixed assets of municipal enterprises.

*Commissioned tasks fulfilled by private enterprises.* LGEs do not provide information on the fulfillment of the commissioned tasks by private firms at all.

*Liabilities and contingent liabilities.* LGEs inform neither the government nor the citizens on their contingent liabilities. Current accounting system doesn't allow recording of contingent claims and liabilities. LGEs report on their financial liabilities (including payables) to the Ministry of Finance and to the State Treasury. Data on payables is aggregated by the Treasury and included into the special reports. These reports are prepared quarterly and can be obtained via written requests. Data on the LGEs' borrowings and debt is not available at all.

In case of LGEs, the Law does not regulate the procedure and deadlines of adoption and reporting of budget resolution (statement on the main direction of the budget



policy for the next year) at all. Schedule for local budgets' preparation and adoption are defined by the Budget Code.

Descriptive part of the budget draft contains:

- 1) Explanatory note, that consist of
  - information about social and economic conditions of a territory and a forecast of its development for the next year,
  - budget revenue estimates that have to account for losses incurred by tax exemptions,
  - explanations and analysis for the proposed amounts of budget expenditures and their division by functions and programs,
  - description of the proposed system of the intergovernmental fiscal relations,
  - information about the debt repayment and new borrowing;
- 2) forecasts of budget revenues, expenditures and deficit financing for the next 3 years;
- 3) expenditures planned for the next periods with respect to long-term projects;
- 4) list of investment projects for the next and subsequent 3 years;
- 5) information about budget implementation for the current period;
- 6) explanations of the main distributors of budgetary funds.

This information is not accessible by public.

Information about LGE salary costs and administrative expenditures is not completely open. Cabinet of Ministers regulates the wage rates for different categories of LGEs' employees, and establishes the limits for the LGEs' staff. This kind of information is open to public and easy to get. However, data on the actual employment of LGEs and their administrative expenditures is closed. Total expenses on LGEs maintenance are reflected in the Treasury reports that are available through the central government agencies. However, it is impossible to receive this data for any concrete LGE.

Every year, at the stage of State Budget preparation, Ministry of Finance estimates administrative expenditure for every LGE up to the rayon level and accounts for these amounts while determining the Central Budget transfers to local budgets. However, The Ministry of Finance estimates are not obligatory for LGEs and they determine their administrative expenditures independently.

Territorial departments of the State Treasury compile the reports on local budgets execution. Budgetary reports are prepared on monthly, quarterly and yearly basis. Monthly reports consist of indicators for budget revenues and expenditures. Quarterly and annual reports include the following data:

- local budget execution,
- budgetary funds flows,
- consolidated budget execution (for rayon and oblast),
- accumulation of budgetary arrears
- local debt and local borrowing.



As a rule, reports on the execution of local budget are not open to the public. However, some LGE publish relevant information in the local newspaper.

The issue of LGEs' assets has to be considered separately for budgetary agencies funded from local budgets, and commercial enterprises owned by LGEs.

Every budgetary agency reports on the value of financial and non-financial assets to the State Treasury. Treasury aggregates relevant data and includes it into the annual report on budget execution. This procedure applies both to state and local budgets.

Detailed reports on budget execution that include the data on the values of budgetary agencies assets, are not available to public. In some cases, these reports may be obtained by research institutes or other nonprofit entities via written requests.

Annual reports on local budget execution prepared by the Treasury, contain only aggregated data (total for Ukraine) without a breakdown across LGEs.

Municipal enterprises do not report to the State Treasury, but they are liable to statistical reporting (likewise all enterprises). State Statistics Committee aggregates the data and prepares a special bulletin. This bulletin contains the data on the fixed assets and working capital of the municipal enterprises across different oblasts of Ukraine. The problems with the public availability of this information are similar to those mentioned above.

LGEs do not disclose values of their financial and non-financial assets. Only Crimean government announced the values of fixed assets of the communal enterprises in Crimea.

Valuation and depreciation methods are not well prescribed by Ukrainian Laws (budgetary agencies are given to much freedom in this respect). Primary value of the fixed assets (that is a base for depreciation charges) is defined as a cost of purchase and installment of the assets. Every year, the primary value may be changed in accordance with the inflation rate. However, budgetary agencies are not obliged to make revaluations, besides, they can radically change the primary value of the fixed assets in case of a substantial rise in market prices for similar products (unified procedures and methods of calculation are not available). In addition, depreciation allowances are not well regulated. Relevant order of the State Treasury establishes only the ranges of depreciation allowances for 3 groups of fixed assets: 1-5% of the primary value, 2-25% and 3-15%. Thus the ratios of depreciation are decided by budgetary agency independently (within the specified range).

## ***Annex I***

### **Distribution of expenditure responsibilities across governments of different levels**

#### **1. Expenditure responsibilities of the Central level**

- 1) State administration: the legislative power; the executive power; the President of Ukraine;
- 2) judicial power;
- 3) international activity;
- 4) fundamental and applied research of nationwide importance;



- 5) national defense;
- 6) law-enforcement and State security;
- 7) education:
  - a) general secondary education: specialized schools (including boarding schools) based on State property; and secondary social rehabilitation schools;
  - b) vocational education (educational establishments and education-related establishments based on State property);
  - c) higher educational establishments based on State property;
  - d) post-graduate education;
  - e) extra-curriculum educational establishments and activities related to extra-curriculum work with children as per list approved by the Cabinet of Ministers of Ukraine;
  - f) other educational establishments implementing nationwide functions as per list approved by the Cabinet of Ministers of Ukraine;
- 8) health care:
  - a) primary medical and sanitary aid, out-patient and in-patient aid (general hospitals and out-patient clinics implementing specific functions of nationwide importance as per list approved by the Cabinet of Ministers of Ukraine);
  - b) specialized and highly specialized out-patient and in-patient aid (clinics of research-and-development institutes; specialized hospitals, centers, leprosoria; hospitals for war veterans; specialized medical and sanitary departments; specialized out-patient clinics; specialized dental clinics as per list approved by the Cabinet of Ministers of Ukraine);
  - c) sanatorium-and-resort aid (national sanatoria for tuberculosis patients, national specialized sanatoria for children and adolescents, specialized sanatoria for veterans of World War II);
  - d) sanitary-and-epidemiological supervision (sanitary-and-epidemiological stations, disinfecting stations; anti-epidemic activities);
  - e) other health-care programs that provide implementation of nationwide functions as per list approved by the Cabinet of Ministers of Ukraine;
- 9) social protection and social security:
  - a) State specialized pension programs (military pensions for the rank and file and their family members; pensions for retired military, the rank and file and commanders of bodies of internal affairs payable under other pension programs);
  - b) State social assistance programs (cash aid to refugees; compensations for medicines; prosthesis programs; programs and activities related to social protection of invalids; reimbursement of losses incurred by citizens; measures related to return to Ukraine of the Crimean Tartars and other persons of other nationalities illegally deported from Ukraine; yearly one-time cash aid to veterans of World War II; life stipends for war participants; funds transferred to the Unemployment Social Insurance Fund; partial reimbursement of expenses on miners' regress claims);



- c) State support to non-profit-making organizations of invalids and veterans that have the status of national organizations;
  - d) national programs and activities with respect to children, youth, women, and families; and
  - e) State programs to support construction (reconstruction) of housing for certain categories of citizens.
- 10) culture and art:
- a) State cultural and educational programs (national and State libraries, museums and exhibitions of nationwide importance; national parks of nationwide importance; international cultural ties; State's cultural-and-educational activities);
  - b) State theatre/show programs (national theatres, national philharmonic societies, national and State musical collectives and companies and other establishments and activities related to arts as per list approved by the Cabinet of Ministers of Ukraine);
  - c) State support to non-for-profit organizations of culture and art which have the status of national organizations;
  - d) State support to cinematography development programs; and
  - e) State archives;
- 11) State programs to support television, radio broadcasting, press, book publishing, and informational agencies;
- 12) physical training and sport:
- a) State programs to train the reserve and the main national teams and support their participation in national and international competitions;
  - b) State programs on sports for disabled and rehabilitation programs (the Invasport Center, participation in sport competitions for disabled, and training sessions for them); and
  - c) other State sport programs related to physical culture and sports.
- 13) State programs to support regional economic development and high-priority sectors of the economy;
- 14) programs related to restoration of architectural monuments of nationwide importance;
- 15) State programs for development of transport, road sector, communications, telecommunications, and information technologies;
- 16) State investment projects;
- 17) State programs related to liquidation of the aftermath of the Chornobyl catastrophe, protection of the natural external environment, nuclear safety, prevention and liquidation of emergency state and aftermath of natural calamities;
- 18) establishment and replenishment of State stocks and reserves;
- 19) servicing of the State debt;
- 20) elections and referenda;
- 21) other programs of exclusively nationwide importance.



## **2. Expenditure responsibilities of the Towns, Villages and Settlements Taken into Account while Defining the Amounts of Transfers (delegated responsibilities)**

- 1) local self-government bodies of towns, villages, settlements;
- 2) education:  
pre-school education;  
general secondary education (schools with kindergartens);
- 3) primary medical and sanitary aid, out-patient and in-patient aid (district hospitals, ambulatory centers, first-aid and obstetrics centers and first-aid stations); and
- 4) palaces of culture, clubs, and libraries in towns, villages, and settlements.

## **3. Expenditure responsibilities of the Rayon and Cities of oblast subordination Taken into Account in Defining the Amounts of Transfers (delegated responsibilities)**

- 1) state administration: local self-government bodies of cities of Republican (in the AR Crimea) or oblast significance; and rayon-level local self-governmental bodies;
- 2) education:
  - a) pre-school education (for cities of Republican or oblast significance);
  - b) general secondary education: general secondary educational establishments, including: schools with kindergartens (for cities of Republican or oblast subordination), specialized schools, lyceums, gymnasiums, collegiums, evening (shift) schools;
  - c) educational establishments for citizens requiring social assistance and rehabilitation: general boarding schools, general boarding schools for orphans and children without parents' care; children's houses, family-type children's houses and adoptive families; allowances for children in ward; and
  - d) other educational State programs;
- 3) health care:
  - a) primary medical and sanitary aid, out-patient and in-patient aid (non-specialized hospitals, maternity homes, first-aid and emergency stations, out-patient hospitals and ambulatory centers, general dentist's hospitals); and
  - b) health education programs (municipal and rayon health centers and health education activities);
- 4) social protection and social security:
  - a) State social security programs; hospices for adolescents (if at least 70 percent of the roll is formed on the territory of the relevant city/town or rayon); territorial centers and departments for home-care social assistance);
  - b) state social protection programs: benefits to war and labor veterans; cash aid to families with children; additional disbursements paid to citizens to cover rent and utility expenses; compensation payments for transport benefits provided to certain categories of citizens);



- c) State programs to support construction (reconstruction) of housing for certain categories of citizens;
- d) rayon and city programs and activities related to the State's policy to support children, youth, women, families;
- 5) State culture/art and entertainment programs (theatres, libraries, museums, exhibitions, palaces and buildings of culture, children's esthetic schools; and
- 6) State programs to foster development of physical training and sports: maintenance of sport schools and educational and training work in schools for children and youth of any type (except for schools of Republican and oblast subordination); activities related to physical training and sport; and financial support to organizations engaged in physical training and sport and sport facilities of local importance.

#### **4. Expenditure responsibilities of the AR Crimea and Oblasts Taken into Account in Defining the Amounts of Transfers (delegated responsibilities)**

- 1) state administration: representative and executive power in the AR Crimea and oblast radas;
- 2) education:
  - a) general secondary education for citizens who need special assistance and rehabilitation: specialized general-education establishments for children requiring correction of physical and/or mental development; sanatoria with boarding schools; secondary boarding schools for orphans and children without parents' care; children's houses;
  - b) vocational educational establishments that are owned by the AR Crimea and implement the State order;
  - c) higher education (communally-owned educational establishments of the I, II, III, and IV levels of accreditation owned by the AR Crimea and jointly owned by territorial communities);
  - d) post-graduate education (post-graduate institutes for teachers and advanced-training centers for civil servants of local bodies of executive power and local self-governmental bodies; communally owned standing courses (centers) for advanced training of employees engaged in the socio-cultural sector and agro-industrial complex);
  - e) other State educational programs;
- 3) health care:
  - a) primary medical and sanitary aid, out-patient and in-patient aid (hospitals of Republican (in AR Crimea) and oblast subordination);
  - b) specialized medical and sanitary aid, out-patient and in-patient aid (specialized hospitals; out-patient clinics, including dentist's clinics; hospitals for veterans of World War II, children's homes, and blood-transfusion stations);
  - c) sanatorium-and-resort aid (sanatoria for tuberculosis patients; sanatoria for children and adolescents; rehabilitation sanatoria); and
  - d) other State health-care and sanitary programs (medical/social expert boards; forensic medicine bureaus; medical statistics centers, suppliers of special medical equipment, health centers; health education activities; other programs and activities);





4) social protection and social security:

a) state social protection and social security programs: aid to take care of invalids of Groups 1 or 2 with mental disorders; targeted social assistance to low-income families; compensation paid to the rehabilitated; children's boarding establishments; training and job-finding for invalids; hospices for aged and handicapped; hospices for handicapped children; pension centers; hospices for adolescents;

b) Republic-wide (in ARеспублика Crimea) and oblast-wide programs and activities related to the State's policy to support children, youth, women, families; and

c) other State social programs;

5) culture and art:

a) State cultural/educational programs (libraries, museums, and exhibitions of Republican and oblast subordination);

b) State theatre/entertainment programs (philharmonic societies, musical collectives and companies, theatres, palaces and houses of culture of Republican and oblast subordination; other establishments and activities related to arts);

c) other culture/art related State programs; and

6) physical culture and sport:

a) State programs for development of physical culture and sports (training activities in any type of sport schools of Republican and oblast subordination for children and adolescents; measures to support physical culture and sport of Republican and oblast subordination); and

b) State programs related to sports and rehabilitation of the handicapped and oblast centers for handicapped athletes and rehabilitation schools; training sessions and competitions for handicapped athletes of Republican and oblast subordination).

**5. Expenditure responsibilities of the Local Budgets not Taken into Account in Defining the Amounts of Transfers (own responsibilities)**

1) local fire-fighting units;

2) extra-curriculum education;

3) social protection and social security:

a) programs and activities of local importance to support children, youth, women, and families; and

b) local social protection programs for certain categories of the population;

4) local programs to support the housing and communal sector and provision of amenities in settlements;

5) cultural/art programs of local importance;

6) programs to support cinematography and mass-media of local importance;

7) local programs to support development of physical culture and sports;

8) standard design; restoration and protection of architectural monuments of local significance;

9) transport and roads:



- a) regulation of prices for services of metropolitan railways based on decisions of local self-governmental bodies;
- b) exploitation of the road system of local significance (including service provided by specialized assembly/exploitation units); and
- c) construction, reconstruction, and maintenance of commonly used roads of local importance;
- 10) water-rescue activities;
- 11) servicing of local self-government debts;
- 12) local environmental protection programs;
- 13) management of communal property;
- 14) regulation of land-related relations;
- 15) other programs approved by a responsible Rada consistent with law.



## **WORKING MATERIALS**

1. "Constitution of Ukraine", #254k-96BP, from 1996
2. "Budget Code of Ukraine", #2542-III, from 2001

### **1. GENERAL GOVERNMENT ORGANIZATION**

#### **1.1. Legal definition of general government**

1. *The Decree of the President "On Actions for Implementing the Concept of Administrative Reform in Ukraine", #810/98 from 1998*

#### **1.2. Organizational units covered by state budget and local government budget**

1. The Decree of CMU "On Approving the Limit Number of Employees of Foreign Diplomatic Establishments of Ukraine", #508-p from 2002
2. The Decree of CMU "On Limit Number of Employees of Central Offices of Court of Appellate Jurisdiction, Court of Appeal, and Superior Administrative Court of Justice of Ukraine", #572-p from 2002
3. The Decree of the President "On Ministry of Education and Science of Ukraine", #773 from 2000
4. The Decree of the President of Ukraine "On System of Central Bodies of Executive Power", #1572/99 from 1999
5. The Law "On Government Procurement of Goods, Works, Services", #1490-III from 2000
6. The Order of Ministry of Finance of Ukraine "On Approval of Card of Accounts of Accounting of Budget Establishments and The Order of Use of Card Accounts of Accounting of Budget Establishments", #114 from 1999
7. The Order of State Tax Administration "On Approval of The Order of Defining the Structure of Feature of Non-profit Establishments (organizations)", #355 from 2000
8. The Order, instruction (z0019-03) of the State Treasury "On Approval of Instruction on The Order of Reflection of Stocks of Materials and Capital Equipment That Are Supplied Centrally in the Accounting of Budget Entities", #232 from 2002
9. The Order, instruction (z0113-03) of the State Treasury "On Approving the Instruction on The Order of Compilation in the Year 2003 of Monthly Financial Reporting by Entities and Organizations that Receive Funds from State and/or Local Budgets", #17 from 2003
10. The Order, instruction (z0497-00) of the State Treasury "On Approval of Instruction on Correspondence of Sub-accounts of Accounting for Reflecting Major Economic Operations of Budget Entities", #61 from 2000



11. The Order, Instruction (z0787-01) of the State Treasury and Ministry of Economy "On Approval of the Typical Instruction on The Order of Writing off Stocks of Materials and Capital Equipment from the Balance of Budget Entities", #142/181 from 2001
12. The Resolution of CMU "On Approval for the Year 2003 Limit Wage Bill and Number of Employees, and Limit Expenditures for Maintenance of State Local Administrations of Oblast, Sevastopol City, Rayons and Rayons in City Sevastopol", #380 from 2003
13. The Resolution of CMU "On Approval Limit Number of Employees of Apparatus of Ministries, Other Central Bodies of Execution Power and Local Bodies that Are Subordinated to them and Establishing Limits of Cars", #403 from 2000
14. The Resolution of CMU "On Approval of the List of Own Revenues of Budget Establishments, Requirements for their Creation and Directions of their Use", #659 from 2002
15. The Resolution of CMU "On Approval of The Order of Composition, Consideration, Approval and Major Requirements for Execution of Budgets (koshtorysv) of Budget Establishments", #228 from 2002
16. The Resolution of CMU "On Creation of Unified State Register of Enterprisers and Organizations of Ukraine", #118 from 1996
17. The Resolution of CMU "On Labor Rewarding Basing on Unified Grid of Ranks and Coefficients on Rewarding Labor of Workers of Establishments, Institutions and Organizations of Some Industries of Budget Sphere", #1298 from 2002
18. The Resolution of CMU "On Limit Amount of Expenditures on Purchase of Cars, Furniture, Other Equipment and Facilities, Mobile-Phones, and Computers by State Bodies, and Entities Establishments and Organizations that are Financed Entirely at the Expense of the State Budget or a Local Budget", #332 from 2001
19. The Resolution of CMU "On Limit Amounts of Expenditures on Purchase of Cars, Furniture, Other Equipment and Devices, Self-phones, Computers by State Bodies, and Establishments and Organizations That Are Fully Financed from State and Local Budgets", #334 from 2001
20. The Resolution of CMU "Question of Ukrainian State Innovation Company", #979 from 2000
21. The Resolution of the Verkhovna Rada "On Limit Number of Central Office of Verkhovna Rada of Ukraine", #30-IV from 2002

### **1.3. Organizational forms of extra-budgetary institutions**

1. The Decree of the President of Ukraine "On Regulation on Pension Fund of Ukraine", #121-2001, from 2001
2. The Law "On Compulsory State Social Insurance Against Occupational Accident and Occupation Disease, that Caused the Loss of Working Ability", #1105-XIV from 1999
3. The Law "On Compulsory State Insurance Against Unemployment", #1533-XIV from 2002



4. The Law "On Compulsory State Social Insurance Related to Temporal Disability and Expenses Associated with Birth or Funeral", #2240-III from 2001
5. The Law "On Labor Protection", #196/96-VR from 1996
6. The Report of the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupation Disease that caused the loss of working ability "On Insurance Activity, State of Labor Protection in the Economy, Social Protection of Victims of Occupational Accident, Use of Insurance Funds in the Year 2002",
7. The Report of the Fund of Compulsory State Social Insurance Against Temporary Working Disability and Expenses associated with birth and funeral (Published in Uryadovyi Kurier, March 2003)
8. The Resolution of CMU "On Approval of the Budget of the Pension Fund for the Year 2003", #249 from 2002
9. The Resolution of CMU "On Approval of the Resolution on Supervisory Board of the Fund of Social Insurance Against Occupational Accident and Occupation Disease", #752 from 2000
10. The Resolution of CMU "On the Approval of The Order of Submission of Financial Accounting", #419 from 2000
11. The Resolution of the Council of the Fund of Social Insurance Against Occupational Accident and Occupation Disease "On the Budget of the Fund of Social Insurance Against Occupational Accident and Occupation Disease of Ukraine for the Year 2003", #15 from 2003
12. The Resolution of the Council of the Fund of Social Insurance Against Temporal Disability #25 from 2001

#### **1.4. The rules of commercial units' management by the general government**

1. Commercial Code #436-IV from 2003
2. The Decision of the President of Ukraine #1-1/72 from 2003
3. The Decree of CMU "On Management of the Property in the State Ownership", #7 from 1993
4. The Decree of the State Property Fund of Ukraine "On the concept of corporate and dividend policies of the state", #1262, from 2000
5. The Order of CMU "On proposals of Purchase of shares of closed corporation 'UTEL' by state-owned telecommunications enterprise 'Ukrtelekom'", #617-p from 1999

#### **1.5. Central Bank status and its independence guarantees**

1. The Law "On the National Bank of Ukraine", #679-XIV from 1999
2. Policy Paper S9 "The NBU The Decree on long-term refinancing: Good intention, questionable approach", by Veronika Movchan, Olena Bilan and Ricardo Giucci, Institute for Economic Research and Policy Consulting (unpublished) from 2002



### **1.6. Division of financial responsibilities among legislative branch and executive branch**

1. Central Budget The Laws for different years

## **2. GENERAL GOVERNMENT RECORDING AND REPORTING**

### **2.1. Legal rules of accounting system for general government**

2. The Decree of the President of Ukraine "On the State Treasury of Ukraine", #335/95 from 1995
3. The Law "On Financial Accounting in Ukraine", #996-XIV from 2000
4. The Order of the State Treasury of Ukraine "On the Approval of The Order of Submission of Annual Financial Reports by Budgetary Institutions in 2002", #240 from 2000
5. The Resolution of CMU "On the Approval of The Order of Submission of Financial Accounting", #419-2000 from 2000

### **2.2. State budget reporting**

1. Act of the Verkhovna Rada "On the Structure of Budget Classification", #327/96 from 1996
2. Central Budget Laws for different years
3. The Decree of the President of Ukraine "On Regulation on Pension Fund of Ukraine", #121-2001 from 2001
4. The Law "On Compulsory State Insurance Against Unemployment", #1533-XIV from 2002
5. The Law "On Compulsory State Social Insurance Against Industrial Accident and Occupation Disease, That Caused the Loss of Working Ability", #1105-XIV from 1999
6. The Law "On Compulsory State Social Insurance Related to Temporal Disability and Expenses Caused by Birth or Funeral", #2240-III from 2001
7. The Order of Ministry of Finance "On Budget Classification and its Adaptation", #604 from 2001
8. The Order of Ministry of Finance "On Classification of the Revenues and Expenditures of State and Local Budgets", #35 from 1992

### **2.3. Extra-budgetary institutions reports**

1. Instruction (v0012583-01) of the Fund of Social Insurance Against Industrial Accident and Occupational Disease that Caused the Loss of Working Ability "On Approval of Instruction on The Order of Making Expenditures and Accounting of Insurance Funds of the Fund Of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that Caused the Loss of Working Ability", #12 from 2001



2. Order, instruction (z0113-03) of the State Treasury *"On Approval of Instruction on The Order of Compilation in the Year 2003 of Monthly Financial Reporting by Establishments and Organizations that Receive Funds from State of Local Budgets"*, #17 from 2003
3. Report of the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that Caused the Loss of Working Ability *"On Insurance Activity, State of Labor Protection in the Economy, Social Protection of Victims of Industrial Accident, Use of Insurance Funds in the Year 2002"*
4. Report on scientific research work of the Ministry of Labor and Social Policy of Ukraine and National Scientific Research Institute of Labor Protection *"Developing the Project of The Order of Compilation of the Reports on Insurance Activity, State of Labor Protection in the Economy, Social Protection of Victims of Industrial Accidents, Use of Insurance Funds by the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Diseases, and The Order of Reporting to the Specially Empowered Central Bodies of Executive Power and its Publication"*, #7-CC 2002
5. Resolution, instruction (v0016503-01) of the Fund of Compulsory State Social Insurance Against Temporal Working Disability and Expenses Associated with Birth and Funeral *"On Approval of the Instruction on The Order of Receiving, Accounting, and Use of the Funds"*, #16 from 2001
6. The Decree of the President of Ukraine *"On Regulation on Pension Fund of Ukraine"*, #121-2001 from 2001
7. The Law *"On Accounting and Financial Reporting in Ukraine"*, #996-XIV from 1999
8. The Law *"On Compulsory State Social Insurance Against Industrial Accident and Occupation Disease, That Caused the Loss of Working Ability"*, #1105-XIV from 1999
9. The Law *"On Compulsory State Social Insurance Related to Temporal Disability and Expenses Caused by Birth or Funeral"*, #2240-III from 2001
10. The Law *"On Labor Protection"*, #196/96-VR from 1996
11. The Report of the Fund of Compulsory State Social Insurance Against Temporal Working Disability and Expenses Associated with Birth and Funeral for the year 2002 (Published in Uryadovyi Kurier, March 2003)
12. The Resolution of CMU *"On Approval of the Budget of the Pension Fund for the Year 2003"*, #249 from 2002
13. The Resolution of CMU *"On Approval of The Order of Submission of the Financial Reports"*, #419 from 2000
14. The Resolution of CMU *"On Approval of the Resolution on Supervisory Board of the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that Caused the Loss of Working Ability"*, #752 from 2000
15. The Resolution of the Council of the Fund of Compulsory State Social Insurance Against Temporal Working Disability and Expenses Associated with Birth and Funeral *"On Approval of the Amendments to the Statute of the Fund of Compulsory State Social Insurance Against Temporal Working Disability and Expenses Associated with Birth and Funeral"*, #25 from 2001



16. *The Resolution of the Council of the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that Caused the Loss of Working Ability "On the Budget of the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that Caused the Loss of Working Ability for the Year 2003", #15 from 2003*
17. *The Resolution of the Pension Fund (z0046-95) "On Approval of the Instruction on Accounting and Reporting Within the Bodies of the Pension Fund of Ukraine", #11-4 from 1999*
18. *The Resolution of the Verkhovna Rada "On Execution of The Law of Ukraine on State Budget of Ukraine 2001", #31-15 from 2002*

#### **2.4. General government reports**

1. *The Decree of the President of Ukraine "On Regulation on Pension Fund of Ukraine", #121-2001 from 2001*
2. *The Law "On Compulsory State Insurance Against Unemployment", #1533-XIV from 2002*
3. *The Law "On Compulsory State Social Insurance Against Industrial Accident and Occupation Disease, That Caused the Loss of Working Ability", #1105-XIV from 1999*
4. *The Law "On Compulsory State Social Insurance Related to Temporal Disability and Expenses Caused by Birth or Funeral", #2240-III from 2001*
5. *The Law "On Financial Accounting in Ukraine", #996-XIV from 2000*
6. *The Order of the State Treasury of Ukraine "On the Approval of The Order of Submission of Annual Financial Reports by Budgetary Institutions in 2002", #240 from 2000*
7. *The Resolution of CMU "On the Approval of The Order of Submission of Financial Accounting", #419-2000 from 2000*

#### **2.5 Budget preparation**

1. *Central Budget Laws for different years*
2. *The Decree of the Verkhovna Rada of Ukraine "On Main Guidelines of Budget Policy for 2002", #2543-III from 2001*

#### **2.6. Access to public finance documents**

1. *The Decree of the President of Ukraine "On Regulation on Pension Fund of Ukraine", #121-2001 from 2001*
2. *The Law "On Compulsory State Insurance Against Unemployment", #1533-XIV from 2002*
3. *The Law "On Compulsory State Social Insurance Against Industrial Accident and Occupation Disease, That Caused the Loss of Working Ability", #1105-XIV from 1999*
4. *The Law "On Compulsory State Social Insurance Related to Temporal Disability and Expenses Caused by Birth or Funeral", #2240-III from 2001*





5. The Law "On Information", #2657-XII from 1992
6. The Law "On State Statistics", #2614-XII from 1992

### **3. PROCEDURES OF PUBLIC FUNDS MANAGEMENT**

#### **3.1. Legal principles of the tax system and 3.2. Procedures of making tax decisions**

1. The Decree of CMU "Concerning Excise Duty", #18-92 from 1992
2. The Decree of CMU "Concerning State Duty", #7-93 from 1993
3. The Decree of CMU "On Local Taxes and Duties", #56-93 from 1993
4. The Decree of CMU "On Personal Income Tax", #13-92 from 1992
5. The Decree of the President "On Establishing the State Tax Administration of Ukraine and Local State Tax Administrations", #760/96 from 1996
6. The Decree of the President "On Increasing Non-Taxable Minimum and Rates of Progressive Taxation of Incomes of Citizens", #519/94 from 1994
7. The Decree of the President "On Questions related to State Customs Service of Ukraine", #1022/2000 from 2000
8. The Law "Concerning Amendments to The Law of Ukraine "Concerning contributions for Compulsory State Pension Insurance", #2452-III from 2001
9. The Law "Concerning Rates of Contributions for Certain Types of Compulsory State Social Insurance", #2213-III from 2001
10. The Law "Concerning Single Customs Tariff", #2097-XII from 1992
11. The Law "Concerning the Insurance Tariffs for Compulsory State Social Insurance Relating to Industrial Accident", #2272-III from 2001
12. The Law "On Enterprise Profits Tax", #334/94 from 1994
13. The Law "On Land Tax", #2535 from 1992
14. The Law "On Rates of Excise Duty and Import Duty on Some Goods", #313/96-VR from 1996
15. The Law "on State Budget of Ukraine for the Year 2003", #380-IV from 2002
16. The Law "on System of Taxation", #1251-XII from 1991
17. The Law "On Value Added Tax", #168/97-VR from 1997

#### **3.3. Rules concerning public procurement**

1. Journal "Herald of public procurement".
2. Letter "On functioning of the system of public tenders in I quarter 2002", #19-23/1678-10 from 2002
3. The Decree of CMU "On adoption of the Rules of inter-agency coordination of public procurement", #1312 from 2001



4. The Law "On public procurement of goods, works and services", #1490-III from 2000
5. The Order of CMU "On organizational measures concerning the functioning of the system of public procurement", #1469 from 2000
6. The Order of the Ministry of Economy and European Integration "On organization of control over the adherence to current legislation on public procurement of works, goods and services", #238 from 2002

### **3.4. Rules concerning social benefits**

1. The Decree of CMU "On adoption of rules and conditions of free transportation for the deputies of local councils", #702 from 1994
2. The Decree of CMU "On rules and conditions of free transportation for the deputies of local councils", #1738 from 2002
3. The Law "On High Education", #2984-III from 2002
4. The Law "On the basic conditions of the social protection of the veterans of labor and other senior people in Ukraine", #3721-XII from 1993
5. The Law "On the indexation of monetary revenues of the people", #491-IV from 2003
6. The Order of Ministry of Labor and social policy, Ministry of Economics and European Integration, Ministry of Finance, The state committee of construction, architecture and housing policy, Ministry of Energy of Ukraine, the State stock holding company "Ukrigas", "On the approval of the Methodology for granting the population with subsidies for housing and communal services, purchase of liquefied gas, solid and liquid fuel for stoves", #379/2819 (#58/45/91/73/51/23/10-538) from 1998
7. The Resolution of CMU "On the approval of the Act on the Fund of the social protection of invalids", #1434 from 2002
8. The Resolution of CMU "On the approval of the Temporal procedure on the transferring some subventions in 2003 for the execution of expenditures for providing privileges, subsidies and compensations at the expense of revenues to the general fund of the State budget of transit fees for the transportation of the natural gas and for natural gas extracted in Ukraine", #113 from 2003
9. The Resolution of CMU "On the basic conditions of the social protection of the veterans of labor and other senior people in Ukraine", #94 from 1994
10. The Resolution of CMU "On the new size of the costs for the payments for housing and communal services, purchase of liquefied gas, solid and liquid fuel for stoves", #1156 from 1998
11. The Resolution of CMU "On the Procedure of setting, payment and size of the stipends of pupils, students, cadets, registrars, post-graduate students, persons working for doctor's degree", №950 from 2001
12. The Resolution of CMU "On the procedure of the providing privileges, foreseen by The Law of Ukraine On the basic conditions of the social protection of the veterans of labor and other senior people in Ukraine", #552 from 1994



### **3.5. Rules concerning state aid**

1. Commercial Code # 4003-XII from 1994
2. The Law *"On the protection of economic competition"*, #2210-III from 2001
3. The Law *"On Enterprises"*, #24 from 1991
4. The Law *"On protection, unfair competition"*, #236-96-BP from 1996
5. The Law *"On state support for the air-construction industry in Ukraine"*, #2660-III from 2001
6. The Law *"On stimulation of the agricultural sector for 2001-2004"*, #2238-III from 2001

### **3.6. Principles concerning wages and salaries in the public sector**

1. The Law *"On the Remuneration of Labor"*, #108/95 from 1995
2. The Order of the Ministry of Defense *"On the regulation of the conditions of the remuneration of labor of employees of the budget military units, institutions and organizations of the Armed forces of Ukraine"*, #216 from 2001
3. The Order of the Ministry of Education and Science *"On the regulation of the conditions of the remuneration of labor of employees at some budget scientific organizations of the Ministry of Education and science of Ukraine"*, #453 from 2002
4. The Order of the Ministry of Labor and Social Policy *"On the regulation of the conditions of the remuneration of labor of employees at structural subdivisions of the state statistics territorial bodies, which are working at the expense of State budget of Ukraine"*, #412 from 2001
5. The Order of the Ministry of Labor and Social Policy, the Ministry of health care *"On the regulation and establishment of the conditions of the remuneration of labor of employees at the institutions of health protection and the institutions of social protection of population"*, #161/137 from 2001
6. The Resolution of CMU *"On the conditions of the remuneration of labor of employees at budget scientific-research institutions and organizations and other scientific institutions of the National academy of science"*, #74 from 2001
7. The Resolution of CMU *"On the regulation of the conditions of the remuneration of labor of employees at organizations and institutions of some budget sectors"*, #134 from 2001
8. The Resolution of CMU *"On the regulation of the remuneration of labor of employees of the apparatus of the executive power central authorities, local self-governance bodies and they executive bodies, prosecution bodies and courts, etc."*, #2288 from 1999
9. The Resolution of CMU *"On the remuneration of labor on the basis of Unified tariff scale of classes and coefficients of the remuneration of labor of employees working in all institutions, organizations of budget sector"*, #1298 from 2002



10. The Resolution of CMU *"On the setting for year of 2003 the employment limits, the size of remuneration of labor and maintenance costs of oblasna, Sevastopil city, rayonna state administrations"*, #380 from 2003
11. The Resolution of CMU *"On the setting of the employment limits of the apparatus of ministries, other executive power central bodies and their subordinated territorial bodies and establishment of the limits of cars that serve them"*, #403 from 2000
12. The Resolution of CMU *"On the setting of the Procedure of calculations of inter-budget transfers amounts (equalization subsidies, subventions and money transferred to the budget of higher rank) and standards of deductions, state taxes and duties for 2001"*, #1932 from 2000

### **3.7. Making investment decisions**

1. The Decree of CMU *"On The Order of appraisal and tenders for the selection of investment projects foreseeing the participation of funds, the state budget"*, #2145, 1999
2. The Laws *"On Concessions"*, #209-IV from 2002
3. The Law *"On concessions for the building and operation of automobile roads"*, #1286-XIV from 1999

### **3.8. Procedures concerning closing of accounts of the state budget**

1. The Letter of the State Treasury *"On Operations on Annual Closure of Accounts"*, #07-04/1219-9396 from 2000
2. The Order of the State Treasury *"On Approving of "Instruction on The Order of Compilation of Annual Reports on State Budget Execution by Bodies of State treasury of Ukraine"*, #144 from 2000
3. The Order of the State Treasury *"On Approving The Order of Cash Execution of State Budget Expenditures"*, #3 from 2001
4. The Order of the State Treasury *"On Approving The Order of Opening Accounts in National Currency at Bodies of State Treasury"*, #221 from 2002

### **3.9. The principles of public borrowing**

1. Central Budget Laws for different years
2. The Law *"on Domestic State Debt"*, #2604-XII from 1992
3. The Law *"on the National Bank of Ukraine"*, #679-XIV from 1999
4. The of Ministry of Finance *"On The Order of Accounting of State Debt and Operations Connected with it by the Ministry of Finance"*, #42 from 2001

### **3.10. Ethical standards of behavior for public servants**

1. Criminal Code #2341-III from 2001
2. Decrees of the President concerning the fight against corruption



3. The Decree of the President "On the Coordination Committee of the Fight against Corruption and organized crime", #561-83 from 1993
4. The Decree of the President of Ukraine "On improving effectiveness of the activity of the Coordination Committee on the fight against corruption", #402 from 2003
5. The Law "On the Fight against Corruption", #356/95 from 1995
6. The Law "On the Public Service", #3723-XII from 1993
7. The Order of Chief Administration of the State Public Service of Ukraine "On the Guide the Typical Occupational Characteristics of the Public Servants Positions", #65 from 1999
8. The Order of the Chief Administration of Public Service "The General Procedure of Conducting the Exam for the Vacant Places of Public Servants", #30/84 from 2002
9. The Order of the Chief Administration of the State Public Service of Ukraine "On the Addition to the Guide of the Typical Occupational Characteristics of the Public Servants Positions", #94 from 2001
10. The Order of the Ministry of Economy and European Integration "On the conducting of annual evaluation of the accomplishing assigned tasks and responsibilities by public servants of the Ministry who work in trade missions in the diplomatic representative offices abroad", #39 from 2003
11. The Resolution of CMU "On the Administration of the Public Service", #209, 2 from 1994
12. The Resolution of CMU "On the Ascription of Positions in Local Governments to the Corresponding Categories of Positions", #1441 from 2001
13. The Resolution of CMU "On the Board of the Chief Administration of the Public Service", #1303 from 2002
14. The Resolution of CMU "On the Centers of Retraining and raising the level of skills of the Employees of Public Bodies, Local Governments Bodies, Heads of State Enterprises, Institutions, and Organizations", #224 from 1996
15. The Resolution of CMU "On the Procedure of Approval in the Cabinet of Ministers of the Candidates for the Positions of the Heads of Structural Subdivisions of the Central Executive Bodies", #676 from 2003
16. The Resolution of CMU "On the Procedure of Approval of appointment and dismissal of heads of administrations, departments, other structural subdivisions of local state administrations", #1374 from 1999
17. The Resolution of CMU "On the Procedure of Conducting the Competition for the Position of Public Servants", #169 from 2002

## **4. AUDITING PUBLIC SECTOR**

### **4.1. External Audit**

1. Information Bulletins and press releases of the ACU (<http://www.ac-rada.gov.ua/main.asp>)



2. Reports of the ACU
3. The Law "On the Accounting Chamber", #18/98 from 1998
4. The Laws *On the Appointment of the members of the Accounting chamber of Ukraine*
5. The Resolution of CMU "On the regulation of the remuneration of labor of employees of the apparatus of the executive power central authorities, local self-governance bodies and they executive bodies, prosecution bodies and courts, etc.", #2288 from 1999
6. The Resolution of the ACU "On the consideration of the Instruction of the procedure of conducting inspections and audits of the ACU", #25-1 from 1999

#### **4.2. Internal Audit**

1. The Decree of the President "On the Chief control and auditing administration", #65/2000 from 2000
2. The Instructions and Orders of the Chief control and auditing administration.
3. The Law "On the State control and auditing service in Ukraine", #2939-XII from 1993
4. The Report of the Chief control and auditing administration "On the activity of the state control and auditing administrations in 2002"
5. The Resolution of CMU "On the Conduction of the internal audit by ministries and other central executive bodies", #685 from 2002

#### **4.4. Responsibility for the violation of public funds management rules**

1. *The Code of the administrative violations of The Law*, #80732-X from 1984
2. The Law "On the State control and auditing service in Ukraine", #2939-XII from 1993.



## EMPIRICAL RESEARCH

### **Requested information: Recent information on the volume of external state debt of Ukraine classified by creditor, maturity and type of interest rate**

The order of Ministry of Finance "On the Order of Accounting of State Debt and Operations Connected with it by the Ministry of Finance" obliges Ministry of Finance to disclose the information on state debt. Therefore, we check how this legal requirement is fulfilled on practice calling the Department of State Debt of the Ministry of Finance and asking for information.

I called the Department of State Debt and asked for state debt statistics. I was given a phone number of the head of the sub-department of the analysis and planning of state debt policy Mr. Voloshin. When calling to this person I introduced myself and asked the questions I have. Mr. Voloshin said that he has this information since his sub-department works out regular note on state debt situation that is distributed among departments of the Ministry, as well as other institutions that deal with public debt issues (State Treasury, Ministry of Economy etc). He also said that such note is not published, however, it can be given to NGO's representatives. He gave me the contacts of person in his sub-department who is responsible for preparation and distribution of this note. Calling to her I said that I already agreed with Mr. Voloshin that we can get the information we asked for. And so I easily got the information I need from that person.

### **Requested information: Official methodology of calculating shadow economy in Ukraine and the estimated number**

In order to get the official methodology of calculating shadow economy in Ukraine and its estimate, the phone call was made to the respective department of Ministry of Economy and European Integration.

Although the Ministry calculates the shadow economy, they have told that the methodology was not approved yet, and, therefore, they cannot provide any detailed information concerning this methodology. Moreover, they refused to provide the estimated fraction of shadow economy in GDP, even though this number was already published in news. But they have told that the number was used in "The Note of the President to Verkhovna Rada in 2003", where the President points this estimated number. The number is really used there and it is equal to 42.3% of GDP.

However, in a week, we received a phone call from that department and were invited to the meeting where the questions of methodology of calculating shadow economy in Ukraine were discussed.

### **Requested information: Details related to the right to impose sanctions and procedure of conducting the inspections by the State Control and Auditing Administration**

In order to get this information, the phone calls were made to the State Control and Auditing Administration.

The answers were given right away.

**Requested information: Wage levels**

In order to get information on wage levels, I called to DerzhKomstat.

As a result of the phone calls, I was provided with the information on the wages paid in budget sphere. I was not provided with the information on wages paid to public servants and I was told that this information is not disclosed.

**Requested information: Financial statement of Ukrzaliznytsya**

The NGO "Institute of economic research and policy consulting" has turned with the letter to the head of the State Statistics Committee of Ukraine asking for the information on financial statements of transport industry enterprisers. Upon showing this letter to the person responsible for collecting information on transport sector the requested financial statements of Ukrainian railways were provided immediately.

**Requested information: Disaggregated dataset on railway industry**

The NGO "Institute of economic research and policy consulting" has turned with the letter to the State administration of the railway transport of Ukraine with the request to provide detailed data on volumes of passenger transportation, tariff structure of internal passenger transportation, international transportation, information on depreciation of the passenger wagons in 1996-2000, description of financial parameters of Ukrainian railways during the same period and on some other parameters. The letter was registered in State administration on 02.07.2001. The reply, consisting of 53 pages of detailed information was sent to the IER on 05.11.2001. The reply was signed by the first deputy of the general director of the State administration of railway transport of Ukraine.

**Requested information: Number of institutions financed from the state budget and number of entities financed from the local budgets**

The law contains no provisions that require the information on the number of entities financed from the local and state budgets to be published. However, we tried to get such information.

To start, I searched the Internet. As a result I found that, the statistical yearbook contains the information on network of budget entities financed from the consolidated budget is available at the website of the Ministry of Finance. However, this information was not sufficient to find out how many entities were financed from the local budgets and how many of them were financed from the State budget.

The next step was to look at the legislative database to find out some documents that could contain the list of entities financed from state and/or local budgets, or a hint where to search. The result of the various search was short list of effective and ineffective resolutions of the Cabinet of Ministers that stated the list of budget entities of some spheres that should be financed from State budget in different years, for example, the Resolution of the Cabinet of Ministers "On Approving the List of Health-Care Establishments that Should be Financed from the State Budget in the Year 2001" #789 from 11.07.2001, Ineffective resolution of the Cabinet of Ministers "On Base Finance of Fundamental R&D Establishments from the State Budget in the Year 1999" # 864 from 20.05.1999, etc. However, this information was not sufficient for compounding a full list of budget entities financed from the State budget in one particular year.





As a result of the search I also found that, according to the Resolution of the Cabinet of Ministers # 118 from 22.01.1996<sup>38</sup>, it was established the Unified State Register of enterprisers and organizations (USREO) that should contain information on all the enterprisers and organizations of Ukraine. The legislation also stated that USREO should publish booklets and digests basing on the database of the USREO. Hence, it was checked the booklets of USREO. Though, the booklets contained the information on the ownership of the enterprisers and organization, sphere of their activity, and no information on what were the sources of finance of state-owned entities. The representatives of the State Statistic Committee told that this is the departmental information and the Ministry of Finance should have it.

Hence, It was made a call to the secretariat of the Ministry of Finance and asked the phone of the department that had this kind of information. The receptionist answered that she would not give any phone, and proposed to write a letter to the Ministry of Finance (not noting any department or name of the official to whom I should address this letter). In view of previous practice such letters usually does not provide a person with the information.

While looking at the structure of the Ministry of Finance it was decided that the department of consolidated budget might have aforementioned information. It was made several regular calls to the Ministry of finance using the numbers given by the secretariat during a week; however, nobody answered any of the phone calls.

At the end, there was written a letter to the head of the department of consolidated budget with the data request on 23 of April 2003. Within three months there was no answer received.

### **Requested information: The forms of financial reporting of the extra-budgetary funds**

In the legislation it is stated that the extra-budgetary Funds should publish the information on the execution of their budgets. It was tried to obtain more detailed information since it is not available from legislative database and the publicly available information is sketchy.

#### *The Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease*

To start, the phone call was made (using the phone number provided by the phone directory). However, it happened that the Fund has changed their location.

The next step was to call other Social Insurance Funds and asked them for the phone of the Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease. However, nobody had updated contact information of the Fund. At the end, the contact information was received from the announcement that was at the building where the Fund was previously located.

It was made a call to the department of the financial reporting and financial planning, where it was asked for the information. Hence the employer of the Fund provided us with information on the forms and list of financial reporting of the Fund. It was also appointed the meeting for the next day in order to get more detailed information.

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<sup>38</sup> Resolution of the Cabinet of Ministers "On Establishing Unified State Register of enterprises and organizations of Ukraine" # 118 from 22.01.1996



During that meeting, the representative of the department provided us with the hard copies of the financial plan of the Fund, Report on the execution of the fund, the booklet that contains the methodology of compounding the financial and statistical reports of the Fund, and explained the principles of financial planning.

*The Fund of compulsory state social insurance against temporary working disability*

First, It was made a call to the financial department of the Fund.

The employees of the Fund said that this kind of information is not open and made a proposition to write a letter to the Executive Director of the Fund. Hence it was written a letter containing the request for the information. Within 2 days it was received an official response informing that the Fund is not empowered to provide aforementioned information.

### **Requested information: Employment of the extra-budgetary funds**

In order to find the information on the number of persons employed at the extra-budgetary funds, it was tried to look at the legislative database, since it contains the documents that set the limit number of employees of the Pension Fund and the Fund of compulsory state social insurance against unemployment. However, the search did not give me any answer on this question. Hence, the search was proceeded by making calls to the funds.

*The Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease*

It was made a call to the personnel department of the Fund. As a result, it was got an advice to write a letter to the Deputy Executive Director. It was written a letter and the reply was received in a month. The answer did not provide with necessary information. Moreover, it was not directly related to the question.

*The Fund of compulsory state social insurance against temporary working disability*

It was made a call to the personnel department. The employees of the Fund said that in order to get this information, the letter to the Executive Director of the Fund should be sent. Hence, it was written a letter. Within 2 days it was received an official reply informing that the Fund is not empowered to provide this information.

### **Requested information: Data on the execution of Kyiv oblast's budget and consolidated budget of Kyiv oblast for 2002**

Law on Local Self-Governance obliges local bodies to inform the residents on the local budgets execution. Law on Requests by Citizens sets the limits for consideration every request by government body – 30 days and 45 days in extreme circumstances.

On the 25<sup>th</sup> of March the request was sent to Kyiv oblast administration on behalf of independent researcher.

In order to check different possibilities, I composed and sent the requests of 2 forms - the form of letter (sent via post) and the form of electronic message (web site of Kyiv oblast administration provide the visitors with such a possibility).

After 2 month passed no results have been obtained. Kyiv oblast administration sent no reply for the written request. The electronic response informed that the question has not been considered yet.