



GDAŃSK INSTITUTE FOR MARKET ECONOMICS

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**INTERNATIONAL STANDARDS OF OPENNESS AND
TRANSPARENCY OF PUBLIC FINANCE IN
UKRAINE’S LAW AND PRACTICE**

ASSESSMENT REPORT

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Abbreviations used:

ECLSG	–	European Charter of Local Self-Government
GIME	–	Gdańsk Institute for Market Economics
IER	–	Institute for Economic Research and Policy Consulting
INTOSAI	–	International Organization of Supreme Audit Institutions
IMF	–	International Monetary Fund
CCAA	–	Chief Control and Auditing Administration of Ukraine
NBU	–	National Bank of Ukraine
OECD	–	Organization of Economic Co-operation and Development
UNO	–	United Nations Organisation
GDP	–	gross domestic product
RD IER	–	Diagnostic Report IER
SAI	–	supreme audit institution
SDDS	–	Special Data Dissemination Standard
VAT	–	value added tax

1. Introduction

1. This report closes subsequent stage of the project carried out commonly by the Gdańsk Institute for Market Economics (GIME) and Kiev Institute for Economic Research and Policy Consulting (Інститут Економічних Досліджень та Політичних Консультацій), called hereinafter – IER.

The aims of the project, financed by the Poland–America–Ukraine Cooperation Initiative – PAUCI are as follows:

- 1) assessment of legal regulations and practice of public sector functioning in Ukraine in relation to international transparency and openness standards of public finance,
- 2) formulating recommendations relating to the state of transparency and openness of Ukraine public finance.

2. The main basis of evaluations presented below was the material developed in the IER and entitled *Fiscal Transparency and Openness in Ukraine. Diagnostic report*¹. The report presents basic issues relating to the organization and functioning of Ukraine public finance sector. The structure and content of the report was discussed and settled with the GIME at the very early stage. GIME team working on this assessment report used also other sources, and the following should be mentioned in particular:

- additional materials, information and explanation passed onto IER employees on working terms,
- Ukrainian legal acts,
- reports and papers of International Monetary Fund, World Bank and OECD,
- information originating from Polish and Ukrainian economy, political and financial portals.

3. The fact that this assessment was preceded by an extensive diagnostic report developed by IER makes it redundant to document in details opinions and evaluations presented. We are concentrating on indicating these problems and phenomena, which prove that the international standards of public finance functioning has not been fully implemented in Ukraine, without detailed description of the facts constituting the legal grounds for these opinions.

The role of this report in throughout project, consisting in indicating topics that should be subject to recommendation creates interest in negative phenomena. Authors of the report would like to underline that on noticing numerous imperfections and lacks, they also see profitable changes in Ukrainian public

¹ The authors of the report are: Iryna Akimova, Oleksandra Betliy, Nataliya Leshchenko, Ivan Poltavets, Dimitriy Sologoub and Tatyana Vakhnenko. In the subsequent part of the report, reference to this document shall be marked as 'DR IER'.

finance made for the past years. They also state that despite relevant differences in conditions and flow of political system transformation processes in Ukraine and Poland there are many possibilities to exploit experience gained in Poland.

4. Next stage will consist in working out recommendations relating to fuller implementation of standards of openness and transparency in public finance together by teams of both Institutes participating in the project. The result of this work will be publicly presented in Kiev and Warsaw at the end of the year.

2. Assessment criteria

5. The adopted method of assessing openness and transparency of public finance in Ukraine is based on confronting existing legal acts and practice of public sector functioning with standards and recommendation defined in the following five documents:

- 1) *Revised Code of Good Practices on Fiscal Transparency* worked out by IMF experts²,
- 2) European Charter of Local Self-Government³, passed in Strassbourg on the 15th of October 1985, ratified (without exemptions and restrictions) by Ukraine in 1997, in force from the 1st January 1998,
- 3) *OECD Best Practices for Budget Transparency*⁴,
- 4) *International Code of Conduct for Public Officials*⁵, adopted by the UN General Assembly in 1996,
- 5) auditing standards, adopted in 1991 by the International Organisation of Supreme Audit Institutions (INTOSAI)⁶.

2.1. IMF's Code of Good Practices on Fiscal Transparency

6. *IMF's Code of Good Practices on Fiscal Transparency* (called hereinafter: the IMF Code) is a set of recommendations for fiscal sector and budget procedures organization developed by IMF experts. The recommendations are not binding, however the IMF recommends the member states to implement them possibly to the fullest and it evaluates the compliance of the law and practices of the member states to the principles of the Code.

The Code concentrates on issues of defining the scope of the fiscal sector and clearly determining procedures which exist in the sector. Separate recommendations relate to free access to fiscal information, budget procedures transparency and necessity for independent audit of public funds management.

7. Most important recommendations of the Code are as follows:

- General government should be easily distinguished from rest of the economy, and policy and management roles within public sector should be clearly specified.
- There should be clear legal and administrative framework for public sector's management.
- The public should be provided with full information on the past, current and projected fiscal activity of government.
- A commitment should be made to the timely publication of fiscal information.
- The budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget and major fiscal risks.

² <http://imf.org/external/np/fad/trans/code.pdf>

³ <http://conventions.coe.int/Treaty/EN/cadreprincipal.htm>, ETS No. = 122

⁴ <http://www.oecd.org/dataoecd/33/13/1905258.pdf>

<http://www.oecd.org/dataoecd/33/15/1905274.pdf> (po ukraińsku)

⁵ <http://www.un.org/documents/ga/res/51/a51r059.htm>

⁶ http://www.intosai.org/2_CodEth_AudStand2001_E.pdf

- Budget information should be presented in a way that facilitates policy analysis and promotes accountability.
- Procedures of the execution and monitoring of approved expenditure should be clearly specified.
- Fiscal information should be subjected to independent scrutiny by the national audit body, established by the legislature, and providing timely reports for the legislature and public.
- A national statistics agency should be provided with the institutional independence to verify the quality of fiscal data.

2.2. OECD Best Practices for Budget Transparency

8. *OECD Best Practices for Budget Transparency* concentrates on public information on budget issues – mainly at the state level. The following three issues are of particular importance:

- publishing information on all stages of budgeting and linking budget financial indices with information on aims and tasks the budget is to accomplish,
- incorporating issues not directly visible in the budget, which are however relevant for public finance into the budget information,
- providing citizens with access to professional and independent assessment of budget data quality.

9. OECD recommends that during budget process the following reports are published:

- budget assumptions, containing – in particular – economic and fiscal policy objectives, government’s economic and fiscal policy intentions and economic assumptions,
- budget execution during the fiscal year (monthly and mid-year reports),
- actual (year-end) results of budget execution,
- the general state of government finances immediately before an election,
- long-term financial perspective.

OECD also points out that together with budget data there should be published information on facts and phenomena which are not directly reflected in the budget, but they influence strongly public finance. For instance, these are the following data:

- deviations from the forecast of the key economic assumptions underlying the budget,
- tax expenditures and their cost,
- government’s financial assets and financial liabilities,
- non-financial assets,
- employee pension obligations contingent liabilities
- *contingent liabilities*, resulted from the government loan guarantees and from the legal claims against the state.

10. OECD points out that there is a need to make public the principles governing reporting data. It also recommends to create internal audit of reports prepared and to set personal responsibility for correctness of the reports published. Finally, OECD recommends that the report on budget execution is subject to assessment by Supreme Auditing Institution (SAI) and the Ministry of Finance enables both citizens as well as specialized non-governmental organizations to access the budget data.

2.3. European Charter of Local Self-Government

11. *European Charter of Local Self-Government* (ECLS) passed by the Council of Europe in 1985 is a set of political and financial guarantees that the states joining the Charter should grant to their local self-government units. When joining the Charter the state is not required to adopt all obligations defined in the

Charter⁷. Ukraine ratifying the ECLS did not notify any reservations to the provisions of the ECLS. Therefore, based on the article 9 of Constitution of Ukraine, the entire ECLS became a *part of the national legal system of Ukraine*.

12. Most important provisions of the ECLS are as follows:

- The principle of local self-government, denoted as the right and the ability of local authorities to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population, should be recognised in domestic legislation, and where practicable in the constitution.
- Members of self-government councils should be freely elected by secret ballot on the basis of direct, equal, universal suffrage.
- Powers given to local authorities should normally be full and exclusive.
- Changes in local authority boundaries should not be made without prior consultation of the local communities concerned, possibly by means of a referendum.
- Local authorities shall be able to determine their own internal administrative structures.
- Any administrative supervision of local authorities may only be exercised in such cases as are provided for by the constitution or by statute. Any administrative supervision of the activities of the local authorities should normally aim only at ensuring compliance with the law and with constitutional principles.
- Local authorities should have the right to own adequate (commensurated with the responsibilities provided for by the constitution and the law) financial resources, of which they may dispose freely. Part at least of the financial resources of local authorities should derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.
- The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support.
- As far as possible, grants to local authorities should not be earmarked for the financing of specific projects.
- Local authorities have the right of recourse to a judicial remedy in order to secure free exercise of their powers and respect for principles of local self-government.

2.4. Ethical standards for Public Officials

13. We adopted provisions of the International Code of Conduct of Public Officials as grounds for evaluating how Ukraine respects commonly adopted standards in functioning of public service. We also examined compliance of the Ukrainian law and practice to OECD recommendations and to anti-corruption strategy announced by the World Bank.

14. International Code of Conduct of Public Officials constitutes an annex to the resolution of UN General Assembly dated December 12, 1996 on fighting corruption. It regulates the issues relevant for fighting corruption and correct functioning of public officials.

- **General principles.** A public office should act in the public interest. The loyalty of public officials shall be to the public interests of their country as expressed through the democratic institutions of government. Public officials shall ensure that they perform their duties and functions efficiently, effectively and with integrity, in accordance with laws or administrative policies. Public officials shall be attentive, fair and impartial in the performance of their functions and in their relations with the public. They shall at no time afford any undue preferential treatment to any group or individual or improperly discriminate against any group or individual.

⁷ To ratify the ECLSG it is essential to accept at least 20 out of 30 substantial provisions of the ECLSG. It is possible to reserve application of the ECLSG to some types of self-government units exclusively.

- **Conflict of interests.** The code prohibits public officials from using their official authority for the improper advancement of their own or their family's personal or financial interest and from engaging in any transaction, acquiring any position or function or having any financial or commercial interest that is incompatible with their office, functions and duties. Public officials, to the extent required by their position, shall declare business, commercial and financial interests or activities undertaken for financial gain that may raise a conflict of interest. In situations of possible or perceived conflict of interest they shall comply with the measures established to eliminate such conflict. Public officials shall at no time improperly use public moneys, property, services or information that is acquired in the performance of their official duties for activities not related to their official work.
- **Disclosure of assets.** Public officials shall, in accord with their position and as permitted or required by law and administrative policies, comply with requirements to declare or to disclose personal assets and liabilities.
- **Acceptance of gifts or other favours.** Public officials shall not solicit or receive directly or indirectly any gift or other favour that may influence the exercise of their functions, the performance of their duties or their judgment.
- **Confidential information.** Matters of a confidential nature in the possession of public officials shall be kept confidential also after separation from service (unless national legislation or the needs of justice strictly require otherwise).
- **Political activity.** The political or other activity of public officials outside the scope of their office shall, in accordance with laws and administrative policies, not be such as to impair public confidence in the impartial performance of their functions and duties.

15. OECD prepared 12 main principles relating to the ethics in public service. There are as follows:

- Ethical standards for public service should be clear.
- Ethical standards should be reflected in the legal framework.
- Ethical guidance should be available to public servants..
- Public servants should know their rights and obligations when exposing wrongdoing.
- Political commitment to ethics should reinforce the ethical conduct of public servants.
- The decision-making process should be transparent and open to the scrutiny.
- There should be clear guidelines for interaction between the public and private sectors.
- Managers should demonstrate and promote ethical conduct.
- Management policies, procedures and practices should promote ethical conduct..
- Public service conditions and management of human resources should promote ethical conduct.
- Adequate accountability mechanisms should be in place within the public service.
- Appropriate procedures and sanctions should exist to deal with misconduct.

For fighting corruption it is vital to provide transparency in employing officials, i.e. to publish recruitment principles, information on vacancies, recruitment based on substantial criteria and clear rules for promoting as well as providing employment security.

16. The World Bank, in its anti-corruption strategy in relation to the public sector management, mentions the following aspects of key importance for limiting and fighting corruption:

- a meritoric civil service with monetized, adequate pay,
- enhancing transparency and accountability in budget management,
- enhancing transparency and accountability in taxes and customs,
- policy reforms in sectoral service delivery,
- decentralization with accountability.

2.5. INTOSAI audit standards

17. Audit standards, adopted by International Organization of Supreme Audit Institutions (INTOSAI) in 1991, are a set of recommendations worked out on the basis of agreement between Supreme Audit Institutions (SAI's) being the members of INTOSAI.

18. INTOSAI audit standards were put into four groups. The first one contains basic assumptions of the fiscal audit and the second one describes general audit standards. The third defines field standards and the fourth one (which we shall not refer to later on) specifies requirements relating to the form and content of audit reports.

19. Basic audit assumptions are recommendations connected with the audit environment. Only a part of them is directly addressed to SAI. Majority refers to conditions facilitating SAI operations, such as promoting by authorities accountability, unified accounting principles and internal audit. In this volume there are definitions of the basic terms (performance audit, etc.).

20. General standards emphasize the importance of four aspects of SAI operations. The first one is independence – understood in the institutional sense (SAI) as well as professional (auditor). The next aspect consists in competencies, i.e. situation in which both SAI and the auditor have appropriate knowledge and experience. The next attribute of SAI operations should be so called *due care*, which denotes aiming at maximal reliability in audit. The remaining standards are related mostly to desired activities in the scope of SAI and its employees development policy.

21. Field standards are a set of recommendations related to the organization and carrying out of the audit. As per the most important ones, each audit should be carefully planned, the documentation should be verified by the auditor's supervisors, and proofs gathered should be of appropriate quality. During the audit one needs to remember about examining compliance of the activities controlled to the existing law.

3. Constitutional grounds of Ukraine fiscal system

22. Constitution of Ukraine contains numerous legal regulations for fiscal system functioning. None of these regulations is compliant to the standards we examined. But in many important issues the Constitution does not contain sufficient guarantees of incorporating these standards in the legal act of lower level.

23. Division of competencies in issues related to the state budget is in general included compliant to the international standards and practice in the Constitution of Ukraine. Cabinet of Ministers (government) is responsible for preparing the draft budget, budget execution and presenting the report on budget execution. The Verkhovna Rada of Ukraine (parliament) is responsible for adopting the budget and report on budget execution. It is also responsible for adopting possible amendments in the budget. There are three issues that need special attention:

1. The constitution does not contain any limitations in the scope of amendments the Verkhovna Rada of Ukraine can implement to the governmental draft budget. This way, the government, being responsible for budget execution by force of Constitution, remains unprotected against changes in the draft budget having political background, which may result in breaking down macro-economical logics of the budget and actual budget unfeasibility. It is even more dangerous bearing in mind that Constitution of Ukraine does not impose any barriers on the amount of state debt and as far as the deficit is concerned it gets down to a statement generally formulated (in the article no. 95): *the state aims at balancing the budget of Ukraine*.
2. There is no clear statement in the Constitution defining which entities, listed in the article 93 as having legislative initiative, can propose amendments to the budget.

3. There are no regulations concerning the situation once the budget is not accepted before the budget year starts.

24. The Constitution gives the Verkhovna Rada of Ukraine (in the article 92) exclusive competencies in the matter of setting public subsidies and budget system, formation and payment of the state debt, inc. the issuance of state securities. There is no clear statement that the state debt have to fall within the range defined by the Verkhovna Rada of Ukraine. A very clear and straightforward ban on deciding on issues related to budget and taxes in the referendum is a very interesting solution.

25. The regulations referring to the central bank are very general. In the article 99 it is only stated that providing stability to hryvna is the basic function of the National Bank of Ukraine and in the article 100 it is stated that the Council of the National Bank of Ukraine elaborates the basic principles of monetary and credit policy. It is interesting to point out that the legal position of the NBU is to be defined by law (in the article 100). In our opinion such a solution does not give sufficient guarantees of central bank independency from the executive authority. This independency is violated already by the fact that half of the members of Council of the NBU are called by the president of Ukraine.

26. As per the article 7 the Constitution, in Ukraine *local self-government is recognised and guaranteed*. Detailed regulations relating to the local self-government included in the articles 140 – 146 do not define clearly the legal character of the local self-government nor constitution-based sovereignty attributes, which would be subject to protection by judicial procedure, which is declared in the article 145. In the light of many provisions of the Constitution (e.g. article 13, article 14, article 140, article 146) the system construction of the local self-government seems to be distant from ECLS standards, being in fact a binding law in Ukraine.

27. The issue of free access to the information on functioning of public authorities, inc. public finance has been emarginated. The article 34 guarantees the citizens right to collect, storing and disseminating information, but there lack regulations clearly defining the obligations of public authorities as far as disclosing and disseminating such information is concerned. It needs to be pointed out that the Constitution, even though in a delicate form (in the article 97) recommends that the report on budget execution is published, but it does not require publishing of the results of the budget execution audit by the Accounting Chamber.

4. Respecting standards in law and practice of Ukraine public finance

In this chapter we shall present remarks and comments to the way in which standards and recommendations described in the Chapter 2 are implemented. We have limited as much as possible elaboration on the facts constituting base for the assessments presented here. Most frequently we got down to indicating the source of the information on such facts.

4.1. Organization of general government

28. In compliance to the IMF Code principles:

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

IMF recommendation requires defining the scope of responsibility for specific governmental authority levels, executive, legislative and juridical authority and set clear coordination mechanisms of managing the budget and extrabudgetary operations. Relations between governmental and non-governmental institutions of public sector should be established.

Most of the aforementioned recommendations are expressed in the Constitution of Ukraine passed in 1996.

In Ukraine the legislative power is executed by the Verkhovna Rada of Ukraine. Its competencies compose of accepting the state budget and its amendments. The Verkhovna Rada of Ukraine controls budget execution and accepts resolutions relating to its execution (article 85 section 4 of the Constitution). The right of legislative initiative in the Verkhovna Rada is given to the President, national deputies, Cabinet of Ministers and the National Bank of Ukraine.

The supreme body of the executive authority is the Cabinet of Ministers. Its competencies compose of preparing the state budget draft and assuring its execution. The executive power in oblasts and districts, in the cities of Kiev and Sevastopol is held by the bodies of local state administration. Local state administration is controlled by bodies of executive power of higher level.

The jurisdiction is executed exclusively by the following courts: Constitutional Court and courts of general jurisdiction.

29. According to the recommendations of the IMF, the central bank – the National Bank of Ukraine (NBU) is an institution that controls key aspects of the financial system. The primary function of NBU is to provide stability to the monetary unit. The regulations of the act on National Bank of Ukraine state also that it should contribute to the stability of the banking sector and prices. NBU is responsible for issuing money and running monetary policy as well as control and supervision of the banking sector. It is forbidden to finance the state deficit by the NBU.

Independency of the central bank is guaranteed by the regulations of the act on NBU, which forbid any executive or legislative authority to interfere with the activity of the Bank. At the same time act on NBU defines exceptions to this principle. NBU is obliged e.g. to carry out consultation on the monetary policy with the government.

As it is stated in the IER report, despite the guaranteed independency of the central bank, the government has attempted several times to engage the bank in quasi-fiscal operations⁸.

30. As per the definition of the IMF, general government comprises departments, branches, agencies, foundations, institutions controlled and financed mostly with state funds and other public controlled organizations engaged in the non-commercial activity. General government can be divided in the following:

- central administration,
- state administration,
- local administration,
- social insurance funds.

In a different perspective, social insurance funds are comprised to the sub-sector of general government, which they operate within.

Legislation of Ukraine does not define the notion of general government. The IER report mentions the following units, which, based on the definition of the IMF, may be comprised into the sector:

- state government bodies, e.g. the legislative, executive and judicial bodies, and local self-governmental bodies,
- entities created by state and local self-governmental bodies, such as:
 - educational state-owned units (different types of all levels schools),
 - health-care state-owned units (e.g. clinics, hospitals and sanatoriums),
 - state-owned units for culture and art (libraries, museums, exhibitions, national parks, theatres, national philharmonic societies, etc.)
 - R&D units that conduct projects of national importance,

⁸ DR IER, p. 14 – 15.

- physical training units,
- social security units (e.g. organizations which activities related to children, youth, disabled),
- legal entities that are created for performance of public tasks and programs,
- social insurance funds (Pension Fund, Fund of Compulsory State Social Insurance Against Unemployment, Fund of Compulsory State Social Insurance Against Industrial Accident and Occupational Disease that caused the loss of working ability, Fund of Compulsory State Social Insurance Against Temporary Working Disability)⁹.

31. As per the definition of the Ukraine Budget Code, budget entities are financed entirely by the budget. Budget entities have their own revenues, which are comprised into the budget in the section called a special fund.

32. As a result of the changes introduced in the budget of Ukraine for the past years, most of the extra-budgetary economy got included into the budget as special fund. The IER report mentions four entities, which, as per the IMF definition, belong to the extra-budgetary institution sector. These are: Pension Fund and three social security funds. All funds are legal persons¹⁰.

4.2. Budget planning and passing

33. Constitution of Ukraine (article 95) states that the state aims at balancing the state budget. State expenses for social needs as well as their amount and purposes are exclusively defined by the State Budget Law. The fiscal year starts on January 1 and ends on December 31. However, in exceptional situations, it is allowed to accept the budget for a different period. Such situations, among others martial law, are mentioned in the Ukraine Budget Code (article 3).

Ukraine Budget Code defines notions related to the budget system. In accordance with these definitions, budget is a plan of collecting and using financial funds which enable to complete tasks and perform functions of official authorities, Autonomous Republic of Crimea, authorities and the units of the local self-government. The consolidated budget is an aggregate of all budgets and is used for economic analyses and forecast. The following are comprised in the budget:

- state budget,
- consolidated budget of Autonomous Republic of Crimea (budget of the Republic and consolidated budgets of regions and cities of republic character),
- consolidated budgets of oblasts and cities separated from oblasts (Kiev and Sevastopol).

The budget consists of the general and special funds. Special funds include funds for expenses from selected sources, grants, subsidies for specific purposes and revenue surplus in relation to special funds. Transfer of the funds from the general fund to the special one is only possible based on the amendments to the budget act. Extra-budgetary funds can only be created by the Verkhovna Rada of Ukraine.

34. In accordance with the article 32 of the Budget Code, Minister of Finance of Ukraine is responsible for preparing the budget draft. The Minister defines most of the principles relating to the organization and methodology of budget planning. Based on the main macro-economy indices and budget executions analyses for the given year, the Minister of Finance determines the general level of budget revenues and expenditures and evaluates the amount of budget financing on preparing the proposals to the state budget draft.

35. The recommendations for the budget policy should be presented by the June 1 the latest (or on the first day of plenary session of Verkhovna Rada scheduled after this date). Such a document should contain, among others:

- limit of the state budget deficit (surplus), expressed in relation to the GDP.

⁹ DR IER, p. 3 – 4.

¹⁰ DR IER, p. 7 – 11.

- scale of redistribution expenses in consolidated budget of Ukraine, expressed as a percentage of GDP,
- limit of the state debt and its structure,
- total of internal transfers.

Limits defined in the recommendation are not binding for the Verkhovna Rada – the Rada may *accept them or consider* (article 33 section 6 of the Budget Code).

Recommendations are based on macro–economy assumptions, in particular relating to the GDP, consumer price index and wholesale price index, projected official exchange rate and unemployment level.

The mode of preparing recommendations is compliant to OECD recommendations relating to the budget assumptions. There lacks information on the aims of the budget economy for subsequent years and definition of the basic fiscal risks to planned budget execution.

36. In accordance with the Code Budget (article 37) the Cabinet of Ministers approves the draft State Budget Law and presents it to the Verkhovna Rada not later than by September 15 of the year proceeding the next budget year. This timeframe is compliant to the OECD standards as per which the budget draft should be presented in the Parliament not later than 3 months before the fiscal year starts. The documents that should be attached to the draft are as follows:

- information on the state economic situation and on the major macroeconomic indicators,
- estimates of the revenues and other sources of financing for the expenditure planned,
- information on state debt payment, inc. the type of debt liabilities, payment deadlines and the amounts of the borrowing,
- forecast of macroeconomic indices and estimated amounts of the consolidated budget for the next three budget periods,
- consolidated budget of Ukraine and consolidated balance of financial resources,
- a list of tax exemptions together with the assessment of the influence they may have on budget income,
- amount and structure of liabilities related to the state debt and guarantees,
- a list of investments to be subject to guarantees proposed by the Cabinet of Ministers,
- a report on the state budget execution for the current budget year.

37. Legislation relating to budget preparation procedures is mostly compliant to OECD standards. However there is no information on financial assets and liabilities of the central administration, non–financial assets and employee pension obligations in the budget documents. The targets of the fiscal policy are not defined either, nor are the dangers to the execution of the budget presented, which is strongly emphasized by the IMF.

The budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks..

38. Chapter 7 of the Budget Code of Ukraine describes in details the process of accepting the budget law. Despite the fact that the Cabinet of Ministers are responsible for preparing the budget, when working on the budget for 2003, during the second reading the Budget Committee of the Verkhovna Rada presented its own budget draft and it got accepted by the Verkhovna Rada¹¹.

Verkhovna Rada of Ukraine should accept the budget law by December 1 of the year proceeding the year the act relates to. In practice this timeframe is not respected, the budget law for 2003 was passed on December 26 and for 2002 on December 20¹².

39. Legislation of Ukraine assumes a possibility of not passing the budget law before the beginning of the fiscal year, determining conditions based on which the budget expenses may be executed.

¹¹ DR IER, p. 15.

¹² DR IER, p. 24.

40. Amendments to the budget law may be made in case of serious deviation from forecasted value of budget revenue and changes in the structure of expenditure. The budgets amendments should be made by introducing them to the budget law. Legislation of Ukraine does not include limitations of the legislative initiative in reference to the amendments in the budget law.

The Budget Code (article 53 and 54) assumes special procedures in case of amendments to the budget resulting from underestimation of revenues or overestimation of expenditures.

4.3. Budget execution

41. IMF Code recommends that all expenditure of the public funds have legal basis. In Ukraine this requirement is not met. The following are the basic problems in state budget execution: granting significant aid to budget units and state-owned enterprises not presented in the budget; unclear and extensive system of tax redemptions and deductions and lack of principles of granting public aid, sharing cash expenses and delays in payment of state budget liabilities, which is related to taking up expensive loans (if there is interest accrued on the liabilities overdue) and losing credibility of the state.

42. The following rule of the IMF Code is a reference to evaluate the tax system:

Taxes, duties, fees, and charges should have an explicit legal basis. The laws and regulations should be easily accessible and understandable, and clear criteria should guide any administrative discretion in their preparation.

Competency of executive authorities relating to settling the amount of specific taxes and levies is too extensive. In accordance with international standards central taxes and other public subsidies are imposed by the parliament. This principle was infringed in relation to local taxes, whose limits are set by the decree of the Cabinet of Ministers¹³. The income tax on individuals is still charged based on the decree of the Cabinet of Ministers and President despite the fact that for several years there has been a constitutional principle of setting public subsidies by the Verkhovna Rada.

No clear differentiation between taxes and other levies in favor of the governmental sector decreases comprehensibility of the budget policy applied. There are too many different taxes (14 common taxes and 14 local taxes)¹⁴. Tax regulations are unclear and applied arbitrarily by the tax administration. High tax rates and complicated legal regulations result in small tax collection. The regulations are frequently modified. However, a gradual improvement can be noticed as the number of taxes is gradually limited and the decrease in tax rates is planned.

43. Tax arrears in 2002 are estimated to amount 32% of the consolidated state budget income. It is related to the fact that rights and duties of taxpayers are not executed. Taxpayers do not fulfill their obligations towards the state and, on the other side, their rights are not respected, e.g. budget arrears on VAT return amount 50% of the income on VAT projected for 2002¹⁵.

44. The principle of equal treatment of taxpayers is infringed. For several years the budget act has contained regulations enabling the companies of National Defense to settle with the budget by means of bill of exchange¹⁶. Numerous sector privileges for certain social and professional groups or regional privileges constitute also a departure from the equality principle.

45. The principles of granting tax deductions and redemptions are not clearly and transparently described. Public opinion is only informed on the list of tax privileges, but the cost of the state for this purpose are not made public (more precisely – the sum of income that will not feed the state budget due to these reasons) nor is the list of entities subject to the aid.

¹³ DR IER p. 28

¹⁴ DR IER p. 27 – 28

¹⁵ DR IER p. 26

¹⁶ DR IER p. 27

List of tax deductions and redemptions is very extensive and it comprises type of redemptions, which are not always clear. It is incompliant to the international standards, because deductions and redemptions are granted based on law, but they limit system transparency. This proves that there exist strong lobbies, which influence the law. Redemptions are granted to industries being socially sensitive or being important due to country defensibility. For example companies of arming industry are redeemed from the customs on the raw materials import, tax on real estate and partially from the income tax. Aviation industry is redeemed from the import customs, tax on means of transportation, VAT and it has also 80% redemption on income tax¹⁷. Similar practice is applied in automobile industry. This results in disequilibrium in running business activity.

46. An act on public procurement, which regulates the purchase of goods and services by the public sector units (inc. regional self-government), has been introduced in 2000. The existence of this act improves the transparency of managing public funds, however not all its provisions are observed in practice. The organization of public procurement does not exclude other forms than open tenders. In the first quarter 2002 about 2/3 of all purchase was executed according to the Request For Price procedure¹⁸. The contracts for the purchase of goods and services for national defense and purchase of 'sensitive' technologies are excluded of the act provisions. There is a fine for infringing the regulation of the act the same as in case of improper management of public funds. In case of detecting incompliance to the procurement procedure, the tender or the purchase may be invalidated. Even though legal regulations seem to be compliant to the international standards, the practice is distant from the principles guaranteeing openness and transparency of public funds management.

47. Expenses for social purposes are defined both by acts as well as decrees of the Cabinet of Ministers. Some of the social benefits are not transferred to individuals who are legally entitled to them because of the shortage of budget funds. The cost of some benefits are transferred to enterprises delivering public services, e.g. enterprises dealing with public transportation are not reimbursed with the costs of respecting discounts on tickets for certain social groups¹⁹.

48. The principles of granting public aid are not clearly and transparently defined. There lack regulations which define conditions of public aid and there is no institution that could supervise this aid. Granting aid is completely voluntary, aid is granted based on the decrees of ministers. There is no reporting on the public aid granted, which contradict the transparency principle of public finance. The bill on accessibility to public aid is being elaborated on.

49. The level of remuneration in the public sector is defined by legal acts and specified by decrees of executive authorities. Delays in paying remuneration from the state budget is not against international codes, but it causes much restrictions. At the end of April 2003 they amounted about 2% of all delays in paying remunerations in entire economy.

50. Procedures on taking investment decision are not completely clear. Ministries individually select companies and projects they want to support with public funds. In case of investment projects where private capital is needed. the plans are available to public opinion²⁰.

51. The issues related to the transparency of budget execution and budget reporting are comprised in the following recommendations:

Budget data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with classified by economic, functional, and administrative category.

The overall balance of the general government should be a standard summary indicator of the government's fiscal position

The fact that liabilities of the public sector units are not included into the state debt is contradictory to this principle. Moreover, there is no formal definition of public debt. There are no data published on

¹⁷ DR IER p. 30

¹⁸ DR IER p. 35

¹⁹ DR IER p. 39

²⁰ DR IER p. 43

contingent liabilities. The Ministry of Finance may grant state guarantees on behalf of the Cabinet of Ministers. There are no limits of the state guarantees that can be granted in the given budget year.

52. The budget deficit is not defined in accordance to the Budget Code, but compliant to the international standards. In the Code the income on the privatization is not treated as the source of budget deficit financing but as budget income (article 15 and 19 of the Budget Code). In practice privatization is considered as a source of deficit financing²¹.

53. The Minister of Finance is obliged to publish information on the public debt every year, but Ukrainian law does not specify what information on public debt need to be published. In practice, most of the relevant information on the debt is published every month. There lacks information on securities, investments and loans granted to enterprises and other units.

4.4. Recording and reporting

54. The issues related to the registry and reporting are regulated both by the IMF as well as by the OECD. IMF standards relating to this issue state:

Budget information should be presented in a way that facilitates policy analysis and promotes accountability. Fiscal data should meet accepted data quality standards.

The methodology and technical issues relating to making budget reports in Ukraine are compliant to international standards.

55. In 2003 Ukraine became the 52nd country which was bound to respect the IMF Special Data Dissemination Standard (SDDS). Ukraine got obliged to pass information on practical usage of standards in reference to the economic and financial data to the Fund .

Operations of the budget system in Ukraine are presented on a cash basis – revenue and expenditure are registered only where they are executed. In accordance to the Budget Code (article 56) the State Treasury of Ukraine comprises all operations of state budget execution in its registry, which reflects all assets and liabilities of the state. Inflow and expenditures are presented on a gross basis.

56. Economic and functional classification of expenditures is compliant to existing standards. Expenditures are also presented by administrative units and budget programs. Since 1998 there has been collected information on income and expenditures arrears (receivables and liabilities) as per economic and functional categories²².

There are no restrictions as per the timeframe for preparing specific reports.

57. The scope of information included in specific budget documents brings biggest objections. Monthly data relate only to budget economy of central administration, quarterly data – to the general government. However, neither monthly data nor quarterly data comprise information on the extra-budgetary economy. Information on extra-budgetary funds (Pension Fund and social insurance funds) is prepared quarterly and it is not included in the publications relating to public finance sector. In 2001 income and expenditures of these funds constituted ¼ of income and expenditure of the general government²³. For 2003 income and expenditure of the Pension Fund were planned to amount 37.6% of the income and 36.5% of the expenditure of the consolidated budget of Ukraine²⁴. Moreover, the accounting of extra-budgetary funds is not always carried out clearly according to the cash basis²⁵.

²¹ DR IER p. 49

²² *Detailed Assessments Using the Data Quality Assessment Framework (DQAF)*, IMF, 2003, p. 70.

²³ *Detailed Assessments Using the Data Quality Assessment Framework (DQAF)*, IMF, 2003, p. 69.

²⁴ DR IER, Kiev 2003, p. 8.

²⁵ L. Figliuoli, I. Shpak, *Ukraine and Fiscal Transparency*, (p. 3, www.imf.org/external/country/ukr/rr/)

58. In accordance with the Budget Code (article 59) the State Treasury of Ukraine submit a monthly report on state budget execution to Verkhovna Rada of Ukraine, Cabinet of Ministers, Accounting Chamber and the Minister of Finance by 15th day of the month following the given month of reporting. Consolidated indices on budget execution, information about the execution of protected items and information on the use of the Reserve Fund of the Cabinet of Ministers have to be presented to Verkhovna Rada of Ukraine and Accounting Chamber by 25th day of the following month and report on budgets arrears not later than on the 15th day of the following month.

Reports on execution of the budget revenue on taxes, fees, mandatory payments as well as on tax arrears and overpayments have to be provided by the 12th day of the month following the reporting one.

59. Monthly data are presented increasingly, which is not compliant to OECD standards. There is also no commentary or explanation which is necessary in particular in case of relevant changes between the forecast and actual execution.

60. Based on the article 60 of the Budget Code, the State Treasury of Ukraine prepares a quarterly report on state budget execution which is presented to the Verkhovna Rada of Ukraine, Cabinet of Ministers, Accounting Chamber and the Minister of Finance within 35 days after the end of the reporting quarter. The report should contain the following information:

- balance sheet of the execution of the state budget,
- cash flow sheet,
- execution of the state budget,
- status of state debt,
- consolidated indices on the budget execution,
- loans and other transactions resulting in liabilities guaranteed by the state.

The revenue collecting units should include information on the losses of revenues due to tax exemptions as well as arrears structure within 35 days once the quarter is finished.

61. OECD standards do not specify the recommendations to the quarterly reports, but they specify their content and the deadline for preparing mid-yearly reports. The Budget Code does not contain separate regulations relating to reports of mid-year. The report after two quarters prepared by the State Treasury of Ukraine does not contain part of the information required by OECD, such as:

- updated forecast of the budget outcome for the given year and the following two years,
- review of the assumptions used in preparing the budget,
- balance of financial and non-financial assets,
- employee pension obligations.

62. In accordance with the Budget Code (article 61), the annual report on budget execution shall be submitted by Cabinet of Ministers to the Verkhovna Rada of Ukraine by June 1 of the following reporting year. The Code specifies the content to the document, which shall include, among others:

- balance sheet of the state budget execution,
- a report on cash flow,
- report on budget arrears and information on the state debt,
- report on using the funds of the Reserve Fund of the Cabinet of Ministers,
- information on local budgets executions.

Despite the fact that the scope of obligatory elements of the report is rather extensive, it still does not contain some of the data required by OECD standards. There is no such information as about:

- quasi-fiscal activity of the state,
- results of the budget programs implemented,
- employee pension obligations .

63. Ukrainian legislation does not assume preparing long-term reports. In accordance to OECD recommendations, such reports should be prepared are least once every 5 years.

4.5. Local self-government finance

64. The basic act defining the principles of functioning of the local self-government is the European Charter of Local Self-Government (ECLSG), which was ratified by Ukraine as a whole in 1997. In spite of the fact that it has been 6 years since the Charter was ratified, fundamental requirements imposed by the charter are still not met. In the Recommendation 102 (2001) dated November 13, 2001 on local and regional democracy in Ukraine²⁶ issued by the Council of Europe, there is a list of in compliance of the Ukrainian law to the content to ECLSG. The main problem still consists in strong concentration of tasks and public funds by state administration and maintaining hierarchical model in relations between various levels of local authorities.

65. Too large number of units at each level of local authorities adopted from the soviet period is a serious obstacle in the process of decentralization of public tasks and winning larger financial independency by self-governments²⁷. The problem of too big dissemination of the local authority relates mostly to the units operating close to the society. Functioning of over 28 000 local self-government units makes it impossible to execute basic public tasks by these units. Even not all local units have their own budget. As per the Ministry of Finance over 11 thousand of units of basic level have their own budget. In the effect several tasks which should be executed by local authorities are delegated to the regional level, where they are handled by state administration²⁸. Such a solution is in compliance to the article 3 of the ECLSG which states that:

Local self-government denotes the right and the ability of local authorities (...) to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population.

Majority of units having small financial capacities would not have any chance of meeting this requirement in even a strongly decentralized system. Also the number of oblasts and rayons is too large so they can rationally run activity supporting regional growth (oblasts) or provide services beyond local scope (rayons)²⁹. Currently, rayons fulfill tasks of self-government units, which are too weak to run independent activity in organizational and financial terms.

66. Local division of the country between self-government units of the basic level is not clear. It is not known exactly how many local self-government units function in Ukraine. Some of the country-side communities choose a council comprising several villages, other villages have their own councils, but only a part of them has any budget enabling to public tasks even in the smallest scope. In reality it is difficult to talk about local self-government in country-side, as village councils do not have sufficient financial and administration resources enabling to execute public tasks.

67. Tasks performed by the local self-government may be divided into own tasks and the tasks of state administration delegated to self-governments. Large part of local tasks executed for the sake of inhabitants was not transferred to self-government competencies. These tasks are executed by the self-government as delegated tasks (commissioned). The tasks commissioned include among others relevant party of the tasks in the field of education, health care and social aid³⁰. Self-governments have a very limited possibility of taking decision in the scope of executing tasks commissioned. By now the article 4 of ECLSG, which states the following has not been implemented:

(...) public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen

²⁶ www.coe.fr/cplre

²⁷ DR IER, p. 67.

²⁸ Kolovitskova O, J. Lukovenko, *Ukraine: Enhancing Local Government Revenue Raising Capacity: A Way of Reaching More Accountable Local Government*, <http://unpan1.un.org/intradoc/groups/public/documents/nispacee/unpan009145.pdf>

²⁹ Slukhai S., *Building-up Fiscally Strong Local Governments – A Challenge For Ukraine*, p.2, <http://unpan1.un.org/intradoc/groups/public/documents/nispacee/unpan009151.pdf>

³⁰ DR IER., p. 84 – 89.

68. In oblasts and rayons councils elected by inhabitants do not have their own administration apparatus, which should be negatively evaluated as far as system transparency is concerned. Oblast and rayon administration is state administration. The council of oblast and rayon controls the activity of state administration in regards to execution of the tasks delegated by this council. At the same time oblast and rayon administration are subordinated to state administration of higher level, which controls execution of state tasks³¹.

69. Collective financial reports published do not show the real participation of self-governments in public expenditure, because large part of self-government expenditure is executed by the state administration³². Many self-governmental tasks are commissioned to state administration in rayons and oblasts. It makes it impossible to get a clear division of tasks and competencies between state and self-government sectors.

70. In Ukrainian law there is a competency allegiance principle of local self-government, which would solve vagueness in the division of responsibility between state and self-government. As a result some of the state activity areas are not clearly assigned to specific units and one does not know who is responsible for their execution. For instance providing specialist medical aid was assigned to both state and self-governmental administration³³. Still article 4 of ECLSG states:

Powers given to local authorities shall normally be full and exclusive. They may not be undermined or limited by another, central or regional, authority except as provided for by the law.

71. Representatives of the state – oblast and rayon – administration interfere directly or not transparently with the activity of self-governments of municipal sector³⁴. As a result there is no clear division of competencies between state and self-governmental authorities. Lack of clear division of responsibility between state and self-governmental administration results also from the fact that most of the self-governmental expenditure is executed or directly supervised by the state administration³⁵.

72. Division of competencies between specific bodies of self-governmental authorities is still unclear. The representative body in municipal units – the council may invalidate the decisions of the board³⁶. This way the council overtakes management capacity, what results in loss in clear function division between the representative and executive. Also the legal status of mayor is insufficiently defined and so is the scope of its allowable intervention in council and board activities³⁷.

73. Regulations relating to the principle of dismiss mayors do not provide sufficient protection to people holding this position. As mayor represents local authorities elected in general elections, possibility to dismiss him otherwise than in referendum should be much limited. In practice, it looks differently: mayor can be lawfully dismissed by the council. As per the Recommendation 102 (2001) of the Council of Europe one of the most frequent reasons of dismissing mayor is the political pressure on the members of the council by the representatives of state administration, which is an evident infringement of the transparency in the division of public authority between state and local-government.

74. Not all financial operations of self-governments are shown in their budgets, which makes it more difficult to maintain transparency. Self-government units running chargeable activity do not have to attach plan of revenue and expenditure to the appropriate budget act. In the local budget there is only a

³¹ DR IER, p 66.

³² Slukhai S., op. cit., p.2.

³³ DR IER, p. 67.

³⁴ Recommendation 102 (2001) on local and regional democracy in Ukraine, point 12D, Rada Europy, <http://www.coe.fr/cplre>

³⁵ Slukhai S., op. cit., p.2.

³⁶ Navruzov Y., Local government in Ukraine, w: Local governments in Eastern Europe, in the Caucasus and Central Asia, red. Munteanu I., V. Popa, Budapeszt 2001, p. 127, <http://lgi.osi.hu/publications/default.asp?id=84>

³⁷ Recommendation 102 (2001) on local and regional democracy in Ukraine, point 12E Rada Europy, <http://www.coe.fr/cplre>

total of revenue of the units running chargeable activity and total of their expenditure³⁸. There is not attachment in the form of a financial plan similar in details to other positions in the budget.

In the law there are contradictions concerning establishment of extra-budgetary funds. The act on local self-government enables such a possibility, while the Budget Code forbids to create funds operating outside unit's budgets³⁹.

75. In the self-government of basic level preparation, accepting and execution of the budget is within competencies of self-government. It is the opposite in rayons and oblasts, where as per Constitution planning, execution and budget reporting are within the competencies of state administration. Independency of rayon and oblast self-governments when working on the budget is then very much limited and gets down to passing the budget bill presented by the state administration⁴⁰.

In the last years self-governments could select the bank to carry out their bank account individually. Last modifications of law resulted in the fact that the bank accounts of self-governments became sub-accounts of the State Treasury, so there is a return centralization of public funds. The self-governments could not manage their own budgets. At the same time self-governments lost one of their financial resources – bank interests and the state gained a free source of short-term crediting⁴¹.

76. In accordance to the Budget Code self-governments are entitled to revenue appropriate to the tasks performed and right to manage the funds they possess. The article 9 of ECLSG states that:

Local authorities shall be entitled (...) to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.

In practice, own revenue are of marginal importance for the functioning of self-governments and only cities and settlements get their own revenue exceeding 10% of the income in general⁴². Some of the local taxes give so little money that it is not profitable maintain them. So far there have not been set more efficient sources of local taxes such as tax on real estate.

77. Self-government insufficiently executes revenue from the property, which results from not having regulated the property rights of local and regional self-government⁴³. The status of buildings transferred to self-governments is also unclear.

78. There are much higher amounts coming out of the participation in state taxes. Contrary to local taxes and levies, shares in the state taxes are not incorporated in own revenue, because self-governments do not have competencies in regards to these income sources. Revenue on PIT and ground tax are transferred to self-governments to finance delegated tasks, so these are not financial funds that self-governments can freely dispose while executing their competencies⁴⁴.

79. Guarantee of covering shortage of funds are limited to executing commissioned tasks and it does not relate to financing of own tasks. Because the amount of proper revenue does not suffice to finance partially local development programs, so self-governments get funds from intransparent sources, i.e. voluntary payment from companies⁴⁵.

³⁸ DR IER, p. 69.

³⁹ *Needs Assessment Report, Ukraine*, World Bank/OECD/CDE Joint Project on Statistical Capacity Building at Subnational Level, Kiev 2002, s. 5, www.worldbank.org/wbi/publicfinance/documents/statistics/Ukraine-Report.pdf

⁴⁰ DR IER, p. 79 – 80.

⁴¹ Slukhai S., op. cit., p.14.

⁴² DR IER, p. 73.

⁴³ *Recommendation 102 (2001) on local and regional democracy in Ukraine*, point 12Cd European Council, <http://www.coe.fr/cplre>

⁴⁴ Slukhai S., op. cit., p.12.

⁴⁵ DR IER, p. 77, Slukhai S., op. cit., p.17.

80. According to ECLSG and the Ukrainian law the state should transfer to self-government funds that would allow them to execute the delegated tasks⁴⁶. In practice, the amount transferred does not suffice to accomplish the tasks given. Self-governments have little possibilities of claim financial claims in court⁴⁷.

81. The self-government of villages and settlements is financially subordinated to rayonal councils, which decide on the transfers from the state budget to specific local units. This is a serious limitation in the independency of local self-governments: in case of financing we deal with the model of hierarchical dependency. If real income is lower than the one planned, the rayons may reduce their own funds deficit by limiting the transfers to municipal units⁴⁸.

The mechanism of funds transfer for the tasks commissioned is very non-transparent. On one hand, funds transferred to oblasts and rayons are to cover the difference between the expenditure for the tasks commissioned and the self-government revenue given to finance these tasks. On the other hand, in order to provide more effective management of the funds and efficient crediting, the amounts transferred are calculated as per various corrective indices agreed by the Ministry of Finance. This results in small transparency in financing delegated tasks⁴⁹.

82. Funds for financing state social programs and investments constitute a different category of transfers from the state budget. The principles for accruing transfer amounts are not transparent and equally dependent on subjective political factors as on objective ones⁵⁰. Acts define standards used to calculate the amount of transfer for financing state social programs, but these amounts are reduced in the budget act.

83. The participation of transfers in self-government revenue is estimated to be high. Funds transferred to self-governments for executing tasks delegated are not self-government property. State administration strictly controls spending of funds for financing delegated tasks by the self-government and local authorities do not have freedom in managing these funds. In consequence, self-governments see no interest in performing the task commissioned in a cheaper way⁵¹.

84. There is no mechanism of efficient control of the extent to which the tasks delegated are performed. In relation to this task category, there is only strict control of direction in which self-governments spend the moneys⁵². Adopting such strategy results from the fact that the state transfers too little funds to finance delegated tasks, so if the extent of their completion were controlled, the first conclusion after control would be to increase amount of transfers. Due to political reasons it is more convenient to control if self-government has actually spent the entire amount transferred for the tasks delegated then to examine to which extent these funds suffice to complete the tasks completely.

85. Legal ban on passing budgets with deficit is a serious infringement of self-government units' independency in some of the categories. Oblasts, rayons and villages are obliged to pass balanced budgets⁵³. Most of the units this cannot realize most urgent investment programs quickly. Completion of these programs needs to be extended over time. Making it impossible for self-government authorities to take up liabilities (except for current liabilities) is not compliant to ECLSG, as it means that local communities do not have access to capital market. And the 8 article of ECLSG states:

For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law

86. In case of units that have possibility of taking long term credits (Autonomous Republic of Crimea, cities) there are too severe fines for delays in paying the liabilities. The ban on taking up new liabilities

⁴⁶ Art. 143 of Constitution

⁴⁷ DR IER, p. 77.

⁴⁸ *Needs Assessment Report, Ukraine*, op. cit., p. 8, Kolovitskova O, J. Lukovenko, op. cit.

⁴⁹ DR IER, p. 78.

⁵⁰ DR IER, p. 75.

⁵¹ Slukhai S., op. cit., p.19.

⁵² DR IER, p. 77.

⁵³ DR IER, p. 76.

for next five years breaches the interest of self-government communities, in particular that the fine is still binding for the councils chosen in next elections.

87. The law of Ukraine states that the data on the activities of self-governments are public and available to all interested. The procedures and mode of making the data available may relate only to confidential information clearly defined in the regulations.

There are more restrictions relating to the access to databases on self-government finance, which are used in analytical work. Unit data on self-government finance are collected by State Treasury offices, but are disclosed to citizens arbitrarily, depending on the decision of officials. Such actions are incompliant to the openness principle declared in regulations: if data on the activities of self-government are public, then there is no reason why the State Treasury should refuse access to the database created out of financial reports of specific self-government units.

88. The State Treasury also gets information on the property of specific budget units, but they are not generally accessible⁵⁴. Lack of obligation to disclose information on the property of self-governments is a serious legal defect. Way of managing the property is an important criterion in assessing the activity of the self-government therefore inhabitants and council representatives should have free access to this information.

89. Regulations on disclosing public information by self-governments precise little the sanctions on violating the agreed proceeding mode. This results in frequent law infringement by governments, which refuse to disclose some of the information⁵⁵.

The regulation binds local self-government units to create generally accessible websites. The law does not precise, however, the scope and mode of placing the information should, and therefore the internet is little helpful as the tool for monitoring the activity of the self-government.

90. Inhabitants are excluded from participating in budget debates. The access to budget acts is also difficult. The description part of the budget acts is not available and therefore inhabitants have no possibility of assessing to which extent the self-government suits their expectations⁵⁶.

91. Detailed information on expenditure of specific self-government units are not disclosed. One does not know what companies are commissioned to execute public tasks neither is known the amount of subsidies. Information on remuneration costs and other administrative costs is also confidential. Inhabitants cannot even know how many employees are employed in the specific unit⁵⁷.

92. The access to the report on the self-government units budget execution is very limited. Actually inhabitants have no chance of getting acquainted with the detailed report on budget execution, so it is impossible to assess the activities of self-government activities objectively⁵⁸.

93. Data on self-government debts and on the revenue on credits and loans are not disclosed. There is no possibility of getting information on the sum of liabilities of specific units⁵⁹. Only collective data on liabilities of self-government sector are published every quarter by the State Treasury.

Having no access to full information, local communities are excluded from the process of managing major parts of public matters and so self-government functioning becomes a problem.

⁵⁴ DR IER, p. 84.

⁵⁵ DR IER, p. 103 – 106.

⁵⁶ DR IER, p. 82 – 83.

⁵⁷ DR IER, p. 83.

⁵⁸ DR IER, p. 84.

⁵⁹ DR IER, p. 76.

4.6. Access to public information

94. Accessibility of public information depends on its openness (publishing) and transparency (comprehensibility). In regards to openness there are two principles formulated in the II part of the IMF Code:

- *The public should be provided with full information on the past, current, and projected fiscal activity of government.*
- *A commitment should be made to the timely publication of fiscal information.*

These entries may be completed by the principle formulated in the section 3.4. of *OECD Best practices for budget transparency*, according to which:

All fiscal reports referred in these Best Practices should be made publicly available. This includes the availability of all reports free of charge on the Internet.

These principles specify three components of openness:

- Wide scope of information,
- Commitment to the timely publication,
- Access to information with relatively easy and cheap means (Internet).

95. Accessibility of the public information means also its transparency (comprehensibility). When it lacks we will deal with the information that is incomprehensible, worthless to the recipient. The principle formulated in the III part of the IMF Code reflects care about this aspect of accessing the information:

Budget information should be presented in a way that facilitates policy analysis and promotes accountability.

Principle of relating to the method of presenting data is very general and it needs to be made more precise in order to avoid misunderstandings. This is supported in following principles of the IMF Code in its IV part, which relate subsequently to:

- Applying acceptable standards of accounting and statistics when presenting (principle 4.1):

Fiscal data should meet accepted data quality standards.

- Existence of an institution, independent from the executive authority which may assess the quality of the data presented (principle 4.2.1):

A national statistics agency should be provided with the institutional independence to verify the quality of fiscal data.

In case the data are far from generally accepted standards, the code emphasizes the necessity to publish calculation and accounting methods (detailed principles 4.1.1. – 4.1.3.).

96. In accordance with the article 95 of the Constitution of Ukraine:

Regular reports on revenues and expenditures of the State Budget of Ukraine shall be made public.

Placement of the regulation relating to the budget reporting in the Constitution of Ukraine confirms high importance of the problem of accessibility to the information on budget income and expenses execution.

This regulation is extended by the article 28 of the Budget Code which presents the list of documents to be published. The following are on the list:

- draft Law on State Budget of Ukraine
- Law on State Budget of Ukraine for the appropriate period with annexes as its integral parts
- information on the execution of the State Budget of Ukraine based on quarterly and annual statements

- information on indicators of the execution of the consolidated budget of Ukraine
- other information on the execution of the State Budget of Ukraine.

The last of the points mentioned above is open and it gives the Minister of Finance possibility to publish any document. And so the state administration bodies decide on the scope of the information made public.

Information included in the documents mentioned are aggregated and their scope comprised either in the budget act or in annual reports is coherent with basic international standards. Explanatory Note to the budget act presents two–option state budget income and expenses forecast in division into basic classification categories and forecast of credit needs and income on privatization. In the reports, there can be found information on financial flows, debts, liabilities and other financial categories defined in the articles 59 – 61 of the Budget Code.

97. It looks a bit different in case of data whose publication is not guaranteed by law and are not aggregated. Even though guarantees of access to such information are presented both in the act on information and in the act on state statistics, applying for such information is difficult and the procedure for granting them has not still been regulated. Then, despite legal guarantee of accessibility and obligation to publish most of the basic fiscal information, access to more detailed data (disaggregated) is still limited.

Research carried out by the IER in 2002 – 2003 confirms that the access to disaggregated data is difficult. There was no answer to the questions on employment addressed to some of the extra–budgetary funds.

98. According to the article 28 of the Budget Code of Ukraine the budget bill should be published in governmental Official Journal *Urjadovyj Kurier* within 7 days once it is presented to Verkhovna Rada of Ukraine, and budget decision of self–governments should be announced the latest 10 days after they are accepted.

Reports on the execution of the state budget (quarterly and annual ones), which needs to be published based on the article 28 have no specific timeframe within which they should be published. In the article 58 – 61 there are only specified deadlines for the State Treasury to present monthly, quarterly and annual reports on the state budget execution to the government, Accounting Chamber and other governmental institutions.

99. Monthly and quarterly reports on the execution of the state budget are published in the website of parliamentary budget committee. And the website of the Ministry of Finance of Ukraine presents information on the public debt. The scope of the information quoted over there is smaller than the one presented in the budget committee website.

Current information on the public finance are also presented in media in the form of statements delivered by the members of the government. The explanatory note of the budget act is not published in media, but is disclosed by the parliament and the state administration.

Free access is granted in case of statistical data collected by statistical agency within the framework of statistical research plan. The remaining data may be purchased. Administration may require additional charge but only in case when it proves that granting this data was related to some extra costs (copying, etc.).

100. Quality of the statistical data – also the fiscal data – is satisfactory and the methods applied in data compilation are in general compatible with the international standards in this field. According to the IMF report *Ukraine: report on the observance of Standards and Codes – Data Module*⁶⁰ (August 2003):

Ukraine's national accounts, prices, monetary, government finance, and balance of payments broadly follow international standards.

⁶⁰ <http://www.imf.org/external/pubs/ft/scr/2003/cr03256.pdf> , p. 4.

Stating good quality of data, we need to remark two issues. Firstly, time series in Ukraine, like in Poland, are in fact often corrected. Most frequently these corrections are justified with adjustments to international standards. In the IMF's report quoted above, the following statement may be found (p. 4):

„...while revision studies are regularly conducted, insufficient information on the procedures used to revise the data is provided to the public.”

Secondly, – we have met this problem during our search for precise estimation of the size of shadow economy in Ukraine – some data are not followed by any description of the applied methodology at all. According to official statistics the size of the shadow economy is evaluated on the level above 40% of Ukraine's gross domestic product. That size definitely requires very precise definition and presentation of the calculation methodology. The low quality of data concerning shadow economy size is also pointed out by IMF in a report *Ukraine: Selected Issues*⁶¹ (June, 2003):

The discussion suggests that Ukraine's GDP may be significantly underestimated.

101. Last but not least element of the accessibility to public information is the existence of independent statistics agency. State Statistics Committee of Ukraine has – in accordance with international standards – guarantees of independence formulated in law “On State Statistics”. The more general conclusion, supporting this view, was presented by IMF in the above mentioned report *Ukraine: report on the observance of Standards and Codes – Data Module*⁶². It states (p. 3):

„Ukraine's statistical agencies have a legal and institutional framework that supports statistical quality.”

4.7. Civil service and anti-corruption procedures

102. In a study conducted by Transparency International on the presence of corruption among politicians and in public administrative structures, the Ukraine came 85th among 102 countries studied⁶³. In the Ukraine, the CPI (*Corruption Perception Index*) for 2002 was 2.4 (on a 10 to 0 scale, where 0 signifies the highest level of corruption).

103. The major breach of anti-corruption principles in the Ukraine is the lack of mass media freedom. The *Global Corruption Report 2003*⁶⁴ describes cases of journalists being murdered as well as severe penalties being imposed on radio and TV stations as well as journalists accused of infringing personal goods. The cases mentioned in the report are from 2001; however, in 2002, the situation did not improve greatly, e.g. in October 2001 a regulation was issued in order to ensure the citizen rights and openness and transparency of the 2002 election. At the same time a law was passed which forbade the publication of information concerning the election in the national and foreign press at the time of the election (March 2002)⁶⁵.

104. Severe financial penalties imposed on the media led to the introduction of self-censorship by both state- and private-owned radio and TV stations when it comes to topics connected with highly placed state functionaries. In the case of newspapers, the authorities use such means of pressure as limiting the availability to subsidized publishing paper, limiting the availability of financial support of the national press support fund, as well as the supervision of local-level functionaries, visits of tax inspectors⁶⁶ and withdrawing of licenses⁶⁷. In order to convince the journalists to follow the administration's recommendations, informal means of persuasion are used, such as threats, beating, pay decrease and removal

⁶¹ *Ukraine: Selected Issues*, IMF (p. 22, point 31, <http://www.imf.org/external/pubs/ft/scr/2003/cr03173.pdf>)

⁶² <http://www.imf.org/external/pubs/ft/scr/2003/cr03256.pdf>, p. 3.

⁶³ *Transparency International Corruption Perceptions Index 2002*, p. 5

⁶⁴ *Global Corruption Report 2003*, Transparency International, <http://www.globalcorruptionreport.org>

⁶⁵ *Global Corruption Report 2003*, Transparency International, p. 173

⁶⁶ *Global Corruption Report 2003*, Transparency International, p. 168

⁶⁷ Human Rights Watch World Report 2003: Ukraine, <http://www.hrw.org/wr2k3/europe15.html>

from post, court trials⁶⁸. On the other hand, the state media enjoy such privileges as subsidized subscription, lower printing costs, renting state-owned office space or distribution through the national postal system⁶⁹.

105. The President's administration regularly issues instructions (tiemniks) as for what information ought to be presented in the press and television, as well as the way of presenting it. These instructions are then distributed among the managers of TV stations and publishers⁷⁰.

Publishing and distribution centers remain under state control⁷¹. Economic instability has forced the majority of media to accept sponsorship and security from major industrial groups who have formed political parties and purchased media outlets. These patrons often use their media holdings as a mouthpiece for personal or group interests and opinions.⁷²

In 1998, the Constitutional Court passed a law limiting the journalists' rights to gather personal information without an expressed consent of the person in question.

106. In the Ukrainian law, all matters which regulate the legal status, employment, remuneration and activity of public officials, and even the ethical norms, were described in the public service law in 1993. The very existence of this law serves to increase the openness and transparency of the public sector. According to the law, all vacant posts in the public service must be advertised, which provides open access to administrative posts⁷³. Public officials go through a recruitment process which, in theory, is based on the principles of competition. However, other procedures, accepted by the Cabinet of Ministers, are also mentioned. The head of administration is nominated and dismissed by the President; his term in office is not defined by law. This means that the division of competence of the executive authorities is not clearly drawn. The President designs the head of administration which in fact is led by the Prime Minister.

107. The IMF Code recommends that the ethical standards of behavior of public officials be clear and commonly known. In the Ukraine, this principle is respected, because the public officials have access to models of behavior, skills and responsibility. These models are in part described by the law (e.g. ethical standards), and in part in the guidelines for public service.

108. Public officials have the obligation to comply with the anti-corruption law. However, there have been several cases of the existent law being violated. This is confirmed by, among others, the Transparency International corruption perception index, or the extent of the shadow economy, officially estimated to make up for 42% of the GDP (although, according to international institutions, this percentage may in fact be twice as high). It is common practice for public officials to run business activity – directly, through their families or representatives. Corruption is also a common phenomenon on the local level, especially when it comes to registering companies and issuing licenses.

109. The law in force concerning the issues of corruption and public service are highly consistent with international standards. The problem, however, is in the lack of instruments which would allow for this law to be executed, as well as the lack of incentives to comply with the law. One can add to this the lack of control on the part of the society; the source of the situation is, on the one hand, the fact that people are

⁶⁸ *Ukraine: Informal Political Censorship*, Human Rights Watch Press Release, <http://www.hrw.org/press/2003/03/ukraine031703.htm> ; *Freedom of the press 2003, A Global Survey of Media Independence*, Freedom House, New York – Washington, 2003, p. 150

⁶⁹ *Media Sustainability Index, Ukraine*, International Research & Exchanges Board, <http://www.irex.org/msi/index.asp>

⁷⁰ *Ukraine: Informal Political Censorship*, Human Rights Watch Press Release, <http://www.hrw.org/press/2003/03/ukraine031703.htm>

⁷¹ *Freedom of the press 2003, A Global Survey of Media Independence*, Freedom House, New York – Washington, 2003, p. 150

⁷² *Ukraine: Informal Political Censorship*, Human Rights Watch Press Release, <http://www.hrw.org/press/2003/03/ukraine031703.htm>

⁷³ In the IMF report *Ukraine. Selected Issues (IMF Country Report, June 2003, <http://www.imf.org/external/pubs/ft/scr/2003/cr03173.pdf>)*, based on the independent research carried out from 1995 to 2002, it is stated that the shadow economy amounts 50–120% of GDP

used to corruption among the authorities and are not willing to change this, and on the other hand, the rather insignificant role of the mass media which are pressurized by the state.

4.8 Management of public property

110. The point of reference for assessing the public goods management system (both goods owned by the Treasury and those owned by units of local authorities), is the first of the basic principles of the IMF Code, according to which

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

This principle emphasizes in particular the necessity to draw a clear borderline between the regulatory function of the state bodies and the actions undertaken by these bodies in order to execute the law of the state (Treasury) as the owner of enterprises and other assets, which are not directly used in performing public tasks.

The public goods management system goes beyond the strictly conceived idea of public finances. On the other hand, in the Ukraine, the importance of this system for budget matters, and the way the procedures of public sector management system influence the perception of the state administration activity has led us to include these matters in our analysis.

111. Despite the clear progress made by the Ukraine in this field during the last period thanks to the passing of new legal acts and the introduction of a common privatization program, which resulted in a decreased state involvement into the SME sector, it is impossible to state that in the Ukraine, the principle of division between the activity of the general government and the remaining (commercial) part of the public sector, is complied with. The major problems in this field we consider to be the following:

- excessive state involvement into economic activity, especially petrol and energy sector, as well as
- non-compliance with the openness and transparency principles in the management of enterprises in this sector⁷⁴,
- the dispersion of state enterprise management among various governmental agendas (ministries)⁷⁵ and the fact that a majority of these ministries also perform regulatory functions over the markets in which operate the state enterprises that remain under the ministries' supervision,
- involvement of local government in the economic activity which goes beyond the framework of public utility tasks⁷⁶.

112. Despite of the ongoing (more or less intense) privatization processes and the introduction of a common privatization program, the state still remains a major commercial enterprise owner. State involvement is particularly strong in the petrol and energy sector (gas, electric energy, coal). At the same time this is a sector which is controlled by quite strict state regulations, including price regulations. This leads to a situation in which the state, as the regulatory body, can (and does) act in the interest of its own enterprises. As a proof of this we can mention the insufficient (although improving) activity of state institutions, aimed at forcing the enterprises to more efficiently execute the profits, along with

⁷⁴ cf. *Staff Report for the Article IV Consultation with Ukraine*, IMF, 2003, p. 20 (<http://www.imf.org/external/pubs/ft/scr/2003/cr03172.pdf>)

⁷⁵ DR IER, p. 13.

⁷⁶ DR IER, p. 70.

“compensating” the profits thus lost by means of fiscal instruments, such as tax reductions and tax exemptions, as well as direct budget subsidies⁷⁷.

All of the above practices not only disorganize the economy, but also stands in quite obvious contradiction to the principle of budget openness – not to mention the fact that it is a major obstacle to achieving a balance in public finances. Let us point out that the mechanism described above actually means that subsidies, tax reductions and tax exemptions enjoyed by state-owned petrol and energy enterprises are secret subsidies for those energy consumers who fail to settle their accounts with energy suppliers. The problem is all the more serious because – as we explain further – the tax reduction and exemption system does not fulfill the principles of fiscal openness.

113. Another problem is the lack of full access to data concerning the functioning of large state enterprises. These enterprises are not obliged to publish – in a clearly defined and comprehensible form – reports on their activity and financial condition; the Government has no such obligation either with regards to enterprises owned by the Treasury. This means that neither all governmental actions concerning state enterprises, nor the results of such actions are subject to independent, public evaluation.

114. The management of particular state enterprises is not concentrated under, or even controlled by, any one administrative body; on the contrary, it is dispersed, often under several minor laws, among various state agencies, specializing in the field of industry appropriate to the given enterprise⁷⁸. We perceive such practice – also from Polish experience – as dangerous not only to the transparency of the government’s functioning, but also for the integrity of the state’s economic policy. Entrusting the management of state enterprises to particular trade ministries is bound to lead to a situation where the “ministry + enterprises” group becomes a unified lobby aimed at preserving their already existing privileges and blocking – usually in an effective way – any attempts at a more profound modernization and restructuring.

115. We would like also to emphasize the lack of general rules and procedures which would regulate the acquisition of shares and equities of enterprises already present on the market by the state as well as – in broader sense – the rules according to which the state may carry out asset investment. The absence of such rules may lead to a significant decrease in the effectiveness of privatization processes due to a parallel “tacit renationalization”. It is worthwhile to add that the possibility of such renationalization based on the decisions of the executive authorities, without a necessity of the Parliament’s consent, breaches the clarity of function division between the two essential state bodies, and thus interferes with the transparency of public finances.

116. According to the data from the Ukraine’s National Statistics Committee, quoted by IER, in 2001 the communal enterprise assets made up for 25.9% of all enterprise assets in the Ukraine, while these enterprises’ share in the overall sales was 1.4%, and their overall financial result was negative⁷⁹. We do not possess data concerning the branch structure of the communal sector, yet from the above facts we can infer the following:

- the scope of activity of communal enterprises goes beyond supplying public utility services,
- the effectiveness of the commercial communal sector is extremely low.

Thus, on both central and local levels, we are dealing with a basic conflict between the interest of the local government as an institution of public authority, acting on behalf of and in the interest of the citizens, and the interest of the very local government as the owner of commercial institutions. The joining of these two functions also leads to a decrease in the effectiveness and credibility of the local authorities as institutions whose tasks include promoting enterprise.

117. Polish experience indicates that extensive commercial activity of the local government usually leads to a loosening of the financial discipline imposed on the enterprises owned by that government, and at the same time it provokes the breaching of rules according to which public tenders are conducted, as well as the regulations concerning the acceptable scope and forms of public aid. In our opinion, the

⁷⁷ cf. *Staff Report for the Article IV Consultation with Ukraine*, IMF, 2003, p. 31 (<http://www.imf.org/external/pubs/ft/scr/2003/cr03172.pdf>)

⁷⁸ DR IER, p. 13.

⁷⁹ DR IER, p. 72.

abovementioned lack of strict rules in the field of granting public aid makes the fact that public authorities manage the bulk of the production structures jeopardizes even more the correct work of the administration and the normal functioning of the market.

4.9 Audit and supervision in the general government

118. The distinction between external and internal audit is based on their relation to the government administration. The external audit is independent from the latter, whereas the internal audit is part of the administration. International audit standards apply mainly to the external audit, which is partly responsible for the openness and transparency of fiscal information.

119. The last part of the IMF Code includes the following statement concerning the functioning of the external audit:

A national audit body, or equivalent organization, should be appointed by the legislature, with the responsibility to provide timely reports to the legislature and public on the financial integrity of government accounts.

The above statement is completed with two OECD recommendations:

The year-end report should be audited by the Supreme Audit Institution in accordance with generally accepted auditing practices.

Audit reports prepared by the Supreme Audit Institution should be scrutinised by Parliament

These principles indicate the essential conditions of an external audit:

- independence from the executive,
- subjection to the legislative,
- the obligation to verify the government's activity and to publish audit reports,
- conducting the audit according to the accepted standards.

120. In the Ukraine, there are as many as three audit services in the general government. The first of them is the Accounting Chamber, which fulfils the international criteria of external auditor. The remaining two services are subject to the executive, and thus play the role of internal auditors. These are: audit units in ministries and in central offices, as well as the State Control and Auditing Service of Ukraine (SCAS). The latter consists of Chief Control and Audit Administration, auditor services of the Republic of Crimea as well as services of local government units.

The high number of auditor services is bound to result in a confusion in the division of their competences. In fact, the activity of the Chief Control and Audit Administration (CCAA) doubles the tasks of the department auditors, at the same time overlapping with the competences of the Accounting Chamber. The CCAA and the Accounting Chamber act in a similar way.

121. The Ukrainian Accounting Chamber possesses – in compliance with international standards – appropriate independence guarantees. The essential one, which at the same time defines the Accounting Chamber's goals, was included in the Constitution. According to art. 98 of the Constitution, the goal of the Accounting Chamber is to supervise, on behalf of the Verkhovna Rada of Ukraine, the use of financial means in the state budget.

122. Further guarantees of institutional independence are included in the Accounting Chamber law. The law decrees the Accounting Chamber's independence from the government and subject to the Parliament. The president of the Accounting Chamber is elected by absolute majority voting in the Verkhovna Rada of Ukraine for a seven-year term of office. The president's closest assistants (deputies, general inspectors and the secretary) are also accepted by the Parliament. The top functionaries of the Accounting Chamber may only be dismissed by the Verkhovna Rada of Ukraine in strictly defined cases. The remaining members of the Accounting Chamber are employed according to the rules described in the public service law.

123. The Accounting Chamber's financial independence is also guaranteed. On the institutional level, the guarantee is based on the direct inclusion of the Accounting Chamber's budget in the state budget draft presented to the Verkhovna Rada of Ukraine. The salary of the Accounting Chamber's members, defined by a regulation issued by the Cabinet of Ministers, are about 30% higher than those of other public officials.

124. The Accounting Chamber's goal formulated in the Constitution is not entirely in line with international standards. Although the Accounting Chamber's activity is characterized by:

- a wide range of public institutions subject to audit (state administration, local administration, as well as private bodies within the scope of public means use),
 - conducting planned audits (including the annual state budget execution control) as well as immediate controls which concentrate on the legality and effectiveness of activities,
 - elements of *ex ante* audit, i.e. issuing opinions on legal act drafts, international agreements, government programs as well as other documents, in the field of their influence on state finances,
- the verification scope is still limited to the expenses of the audited institutions.

Moreover, the practice of controlling the local administration in terms of the effectiveness of public means management is contradictory to the stipulations of art. 8 ECLSG, recommending – especially in case of the local government's own tasks – that the interference of state authorities be limited to cases of illegal activity of local governments.

125. The Accounting Chamber shows due care to make the results of its audits public, which is fully in line with international standards. Conclusions drawn from the audit are first and foremost presented to the Verkhovna Rada of Ukraine, and then to the public opinion.

126. The Accounting Chamber is a member of the INTOSAI and we ought to admit that the practices used by the Accounting Chamber are compliant with the international auditing standards.

127. Another serious objection to the Accounting Chamber's way of conducting the audit is the lack of practice of auditing the Chief Control and Audit Administration (CCAA), in spite of the fact that the possibility of such control is guaranteed by the law. Such a practice negates one of the basic auditing conditions formulated by the INTOSAI.

128. Among other shortcomings of the Accounting Chamber one ought to point out the insufficient organizational background (technical capacity) of the institution. The Accounting Chamber has no regional branches, which certainly make the audit process in public bodies outside Kiev less effective and independent.

129. In its activity, the Accounting Chamber faces problems typical for external auditors. The heads of budget units do not follow the post-audit recommendations, during the audit the authorities of particular units obstruct access to information, etc. These are, however, typical problems which do not distinguish the Accounting Chamber from analogous institutions around the world.

130. The activity of the internal control is compliant with international standards. This applies both to the State Control and Auditing Service of Ukraine, subject to the President, and the auditing units in state offices.

131. According to art. 113 of the Budget Code, the State Control and Auditing Service of Ukraine audits, through its agencies:

- the purposeful and effective use of public means,
- the purposeful and timely payment of loans guaranteed by the Cabinet of Ministers,
- the consistence of account rules and the reports of budget units.

The head of the CCAA, the chief organ of the State Control and Auditing Service of Ukraine is nominated by the Cabinet of Ministers following a motion on the part of the Minister of Finance, to

whom he is directly responsible. In practice, it is the President of the Ukraine who appoints and dismisses the head of the CCAA by an appropriate decree.

132. The inspectors of the auditing services verify the activity of ministries and other executive offices as well as state funds. Private enterprises, institutions and organizations active in the field of use of state means, are also subject to audit. Apart from studying financial operations, the inspectors verify the condition of property state of the audited units. Audit reports are presented to the Verkhovna Rada of Ukraine and the Ministry of Finance.

133. The activity of internal audit units in state offices is based on art. 26 of the Ukrainian budget Code. According to this article, institutions which spend public means are responsible for the organization of internal audit within themselves, as well as in their dependent units. The very procedure of internal audit was described in May 2002 by means of a regulation issued by the Cabinet of Ministers.

The goal of the internal control is to assure the head of the unit that the unit acts in line with the law and with internal procedures, and that it aims at the realization of tasks put forward in the plans. Current internal audit reports are presented to the head of the unit.

Heads of internal audit units in the ministries are appointed by secretaries of state (with the exception of the Ministry of Defense, where the appointment is carried out by the minister). In the remaining state offices, they are appointed by the head of the unit. In each case, the nomination must be accepted by the CCAA.

Due to the recent introduction of legal solutions in this field, internal control services – just like it is in Poland – are now only beginning to fully operate. Only 34 out of 45 ministries and other state institutions created independent internal audit units until the end of 2002.

5. Synthesis of evaluation

134. The comparison of the current openness and transparency of public finance in the Ukraine against earlier reports in this field⁸⁰, allows to state a considerable improvement, especially concerning the existing legal solutions. The Ukraine has a new budget code, the problem of access to information and public tenders has been regulated, first attempts have been made to set in order the procedures of public asset management, a public aid law is being prepared. However, a detailed analysis of the public finance sector leads us to conclude that the Ukraine still falls below several important standards defining commonly accepted principles of organization and functioning of the public finance sector, and the recommendations issued, even several years ago, by such institutions as the Council of Europe, the IMF, the OECD or the World Bank, have yet to be put in practice. Divergences are also well visible between the existing legal norms and the practical functioning of the public finance sector.

135. In our opinion, the major problems due to which the openness and transparency standards are still not being fulfilled in the Ukraine, are the following:

- lack of clear distinction between the competences of particular public authority organs, and lack of clear and consistently applied procedures of public finance and asset management,
- several limitations of the declared liberty of access to information about public finances, due to a narrowly defined range of duties of public authority information organs, as well as to a lack of precisely defined field of secret information and limited freedom of the media,
- conditions of local government functioning, which – with the local government's strong dependence on government administration – fall far below the principles accepted by the Ukraine in the ECLSG,

finally, a problem which in itself is a breach of the standards analyzed by us, and at the same time emphasizes even further the negative effects of the above factors, namely:

⁸⁰ cf. *Experimental Module on Fiscal Transparency for Ukraine*, IMF 1999, <http://www.imf.org/external/np/rosoc/ukr/index.htm#I>

- numerous cases (documented in analyzed documents and materials) of breaking the law in force.

136. We must also mention that public finance openness and transparency standards, even those which have been incorporated into the Ukrainian legislation, are not sufficiently protected by clearly defined constitutional guarantees. This leads to a situation where regulations ensuring the consistency of the Ukrainian law with the international norms and good practice are excessively sensitive to current political pressures.

137. Polish experience shows beyond any doubt that the longer the process of system transformation, the less willing the society and the politicians are to accept the objectively necessary changes, even with an improving economic situation. This should become a premise on which to effectuate the necessary reforms as soon as possible.

138. To sum up, we would like to express our conviction that the best way to the creation of a transparent and effective public finance sector – and at the same time to creating a well-functioning state – is by limiting to the necessary minimum the state interference into the functioning of economy and the local communities, as well as by ensuring a free functioning of all institutions of the citizen society.