Quarterly Report
01 July 2014 - 30 September 2014

Prepared by IBSER for grant
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Abbreviations

AFO	Association of Financial Officers of Ukraine
AUC	Association of Ukrainian Cities
CLC	Commercial Law Center
CPER	Combined Program Evaluation and Review
DHA	District Heating Assessment
EC	European Commission
ESCO	Energy Servicing Company
EU	European Union
FAF	Foreign Assistance Framework
GOU	Government of Ukraine
HCSS	Housing and Communal Services Sector
IBSER	Institute for Budgetary and Socio-Economic Research
LG	Local Government
LINC	Local Investment and National Competitiveness
MBR	Municipal Budget Reform
MFF	Municipal Finance Facility
MFSI	Municipal Finance Strengthening Initiative
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization
OSR	Own-source Revenues
PFR	Public Finance Review
PMP	Performance Monitoring Plan
PPB	Performance Program Budgeting
RTI	Research Triangle Institute
SEFR	Support for Economic and Fiscal Reform
TSA	Treasury Single Account
USG	United States Government
WB	World Bank

Executive Summary

PUBLICATIONS AND REPORTS

- MFSI-II project analysts prepared the publication, *Budget Monitoring for January–June 2014*, drawing from the Treasury Department's preliminary data. The document includes analyses of the latest State and local budget execution trends and relevant legislative acts approved during the reporting period.
- The Project prepared three monthly monitoring reports on the implementation of the State and local budgets for the period from February 2014 to April 2014.
- MFSI-II experts prepared report on the number of specialists who participated in trainings seminar on Financial Mechanisms of Improving Energy Efficiency in the Budgetary Sphere with a breakdown by gender.
- MFSI-II experts prepared analysis of the Draft amendments to the Budget Code and Tax Code of Ukraine.

MEETINGS AND TRAINING

- In the reporting period, experts of the MFSI-II Project completed delivering a series of regional PPB trainings based at the Zakarpattya and Chernivtsi Regional Retraining and Qualifications Enhancement Centers.
- **On 24 August 2014,** experts of the MFSI-II Project took part in a USAID Field Day information fair organized by the United States Agency for International Development (USAID) in Lviv. Thanks to experts of the MFSI-II Project, visitors to the event learned about the principles of municipal budget formation and the benefits of using the Performance Program Budgeting method in the budget process, received professional advice on energy conservation and energy efficiency, and were familiarized with practical steps on how they could influence the formation of their municipal budget.
- **On 5 September 2014**, MFSI-II experts were invited by the Ministry of Regional Development, Construction, and Housing and Communal Services to take part in a meeting held at the Cabinet of Ministers of Ukraine to coordinate the amendments to the Budget Code with regard to ESCO contracts.
- The Municipal Finance Strengthening Initiative-II project and Ministry of Regional Developments finalized the legislative amendments and took part in a Working Group meeting **on 26 September 2014**.
- **On 19 September 2014**, MFSI-II experts hold training seminar on Financial Mechanisms of Improving Energy Efficiency in the Budgetary Sphere (based on the updated training course).
- **On 29 September 2014**, a meeting of the National Advisory Board (NAB) on efficient public finance management took place. At the meeting the participants discussed key provisions of the Draft Law on Changes to the Budget Code of Ukraine (as regards international relations reform) and the Draft Law on Changes to the Tax Code of Ukraine.

DRAFT AMENDMENTS AND RECOMMENDATIONS

- The Ministry of Finance approved its Order of 26 August 2014, No. 836 "On Certain Issues of Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets." The Order incorporates in full the proposals of MFSI-II experts with regard to improved approaches to the Performance Program Budgeting of local budgets.
- The Ministry of Regional Development, Construction, and Housing and Communal Services (MinRegion) invited the MFSI-II experts with the EBRD representatives to finalize amendments to the Budget Code with regard to legislative regulation for implementation of ESCO mechanisms in Ukraine.
- MFSI-II experts updated training course of System for monitoring energy-related budget expenditures for the selected cities in order to facilitate its using. The new system has been updated to comply with the most recent modifications in the budget laws of Ukraine. Thanks to incorporation of the above-mentioned methodology and optimization of the calculation section, the MFSI-II experts have made this system more user-friendly for specialists of local councils and, at the same time, more effective for monitoring and evaluation. Using this system will promote the more transparent and efficient use of local budget resources for energy and strengthen energy saving capacity in the public sector.
- MFSI-II experts provided methodological and advisory support to the city Kamyanets'-Podilskyi in drafting the required resolutions of the Cities Councils and amending the municipal budgets. Experts of the MFSI-II Project have assisted citiy Kamyanets'-Podilskyi obtained approvals from the Cabinet of Ministers of Ukraine for issuing their local guarantees for the city's energy performance project.
- MFSI-II experts updated the Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector.
- The MFSI-II Project experts provided recommendations for improving strategic planning in the context of city development priorities and a more realistic financial justification for the Lviv City Comprehensive Development Strategy.

List of major activities for the next quarter

PUBLICATIONS AND REPORTS

- IBSER will prepare three monthly monitoring reports on the implementation of the State and local budgets for the period from August 2014 to October 2014.
- By the end of the next quarter, MFSI-II experts plan to prepare the *Budget Monitoring for January-September 2014*.
- MFSI-II experts will select four cities for participation in the 4th year of the Project.
- MFSI-II experts will provide consultations to the staff of municipal enterprises on using the methodology of monitoring and evaluating of the energy performance projects and improving the efficiency of the financial justification of strategic documents by communal service enterprises.

MEETINGS AND TRAINING

- A National Advisory Board meeting is scheduled for December 2014.
- Preparation and organization of Financial-Economic Forum in November-December 2014.
- IBSER will provide organizational support to the Ministry of Finance Intergovernmental Working Group and organize its meeting in November-December 2014.
- MFSI-II experts and the Ministry of Finance of Ukraine will continue working together to implement the PPB method at the local budget level.

DRAFT AMENDMENTS AND RECOMMENDATIONS

- MFSI-II will prepare drafts amendments to joint orders of the Ministry of Finance and line ministries that approve standard lists of budget programs and their performance indicators (if needed)
- MFSI-II experts will provide consultations on Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector, including for development of budget programs and individual investment projects.

Key Milestones and Major Deliverables Summary

Objective A: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine

- Proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities developed

  Timeline: October 2013 – September 2014

- Meetings of the working group

  Timeline: 5 and 26 September 2014

- Analysis of the Draft amendments to the Budget Code and Tax Code of Ukraine

  Timeline: September 2014

Sub-objective A.1: Ensure institutional sustainability of the PPB training program(s).

- Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender

  Timeline: July – September 2014

Objective B: Develop and introduce financial practices that foster energy efficiency in 15 selected cities.

- The training course developed and a report prepared on the number of trainings held and the number of specialists who participated in trainings with a breakdown by sex.

  Timeline: July – September 2014

- Consultations on financial incentives to promote the establishment of an effective energy savings system implementation provided to the cities, including for development of budget programs and individual investment projects

  Timeline: April – September 2014

- Consultations to the staff of municipal enterprises on using the methodology provided

  Timeline: January – September 2014

- Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector

  Timeline: November-December 2014

Objective C: Enhance public awareness of the public budgeting process, revenues and expenditures

- Monthly monitoring of national and local budget implementations

  Timeline: second week of every month

- Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process

  Timeline: September 30, 2014

- Preparation and organization of the National Advisory Board

  Timeline: September 29, 2014

- Preparation of Electronic bulletin

  Timeline: July, 2014

- Support the holding of separate information public events in partner cities

  Timeline: August 24, 2014

Tasks and Subtasks

Objective A: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine

Task 1.1: Provide assistance to the GOU (Ministry of Finance, State Treasury of Ukraine, local finance departments, key spending units, specifically) in conducting state-supported pilot programs on Performance Program Budgeting (PPB) and their implementation in local budgets in Ukraine

Sub-task 1.1.1: Develop and formalize system to monitor and evaluate execution of local budget programs for all local government functions

In 2011, IBSER developed the draft methodology for monitoring and evaluating the efficiency of budget program performance. The said proposals were considered at a meeting of the NAB on December 28, 2011, which was attended by members of Parliament, experts of the Verkhovna Rada Budget Committee and other parliamentary committees, Ministry of Finance, and local governments.

The revised methodology was submitted in January 2012 to the Ministry of Finance. The Ministry of Finance of Ukraine forwarded the formula-based methodology developed by IBSER to all participants of the national experiment of PPB implementation under its letter No.31-05010-14-8/4651 dated 13 February 2013.

MFSI-II experts have piloted the methodology of comparative analysis of budget programs based on reporting data of local budgets. More than 750 budget programs of oblast, raion, and city budgets executed in 2012 passed through this evaluation. The results were presented by MFSI-II experts at a joint meeting of the Interdepartmental Working Group and the National Advisory Board on effective management of public finance, which took place on 25 June 2013.

The work is currently in progress to finalize and improve the methodology.

During the third year of implementation, MFSI-II will conduct a comparative efficiency analysis of budget programs based on the reporting data of local budgets. Based on the results of the conducted work, proposals will be prepared to improve the methodology of comparative efficiency analysis of budget programs.

Deliverable: Report on the results of the monitoring and evaluation of the performance of PPB-based budget programs
Timeline: March 2014

MFSI-II experts have tested the updated methodology of comparative analysis of efficiency of budget programs based on the Zhytomyr city budget reporting data. More than 80 budget programs, which were implemented in 2013, have passed through the evaluation. The testing results have made it possible to prepare new proposals for improving the methodology of comparative analysis of efficiency of budget programs.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Deliverable: Proposals for improving the methods of monitoring and evaluation of performance of the local PPB-based budget programs
Timeline: January – March 2014

As the result of conducting a comparative analysis based on the 2013 reporting data and thanks to cooperation with the Department of Finance at the Kyiv City State Administration, the MFSI-II experts have prepared their next proposals for improving the methodology of comparative analysis of efficiency of budget programs. Those proposals will be considered at the next regular meeting of the National Advisory Board.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Sub-task 1.1.2: Complete the legislative, regulatory and methodological framework taking into account the specifics of PPB implementation at various levels of local budgeting

In 2011-2012, the Government of Ukraine reviewed proposals prepared by MFSI-II experts for amending the Principal Normative-Legal Act, which regulates the use of PPB methodology at the local level. These proposals are reflected in amendments to the Ministry of Finance (MOF) Order No.679 "On Certain Issues of Conducting an Experiment of Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets" dated 8 June 2012, No.690, and dated 26 November 2012, No.1221, and registered by the Ministry of Justice of Ukraine.

MFSI-II experts have prepared and submitted to MOF the amendments to MOF Order of 14 February 2012, No. 97 "On Approving the Structure of the Code of Program Classification of Expenditures and Crediting of Local Budgets and the Codifier of Numbering of Standard Lists of Local Budget Programs." The amendments were approved by MOF orders of 4 October 2011, No.1249, of 15 October 2012, No.1101, and of 20 December 2012, No.1386.

MFSI-II experts have reviewed the existing regulatory and legislative framework required for PPB implementation in local budgets and prepared proposals for its improvement. These proposals were submitted for consideration of the participants in the meeting of the National Advisory Board (NAB) on effective public finance management, which was held on 4 October 2013. The participants have supported every proposal made by the MFSI-II Project.

Amendments have been enacted to the Standard lists of budget programs and performance indicators for the delegated functions in the departments of Public Administration, Social Protection and Social Security, Social Protection of Family and Children, and Physical Culture and Sport, as well as similar provisions for the disbursement of expenditures for the implementation of own functions of local budgets. These amendments have been approved by orders of the Ministry of Finance and line ministries (No.1116/673 of 24 October 2012; No. 1060/630 of 8 October 2012; No.1202/1291 of 19 November 2012; No. 1035 of 27 September 2012; and No.35/41 of 22 January 2013). In addition, the experts provided their proposals to modify the Standard lists of budget programs and the performance indicators for the expenditures in the departments of youth and culture. The issued orders incorporate all the proposals made by MFSI-II experts with regard to reducing the number of budget programs and their performance indicators.

MFSI-II experts developed a standard program classification of expenditures and crediting of local budgets and a comparative table of its correspondence to the existing provisional classification of expenditures and crediting of local budgets. New approaches to program classification of local budgets were approved at a joint meeting of the Task Force on Interbudgetary Relations Reform and the National

Advisory Board on Effective Management of Public Finance, held on 25 June 2013. The meeting participants recommended modifications to all documents used in the budget process. The amendments were approved by the MOF order No.705 of 26 July 2013.

Experts of the MFSI-II Project suggested a full-scale implementation of PPB methodology when formulating the budget programs aimed at improving the environmental situation in the regions and health of the population. To this end, the MFSI-II experts developed performance indicators which will evaluate the impact of budget programs on atmospheric air, water resources, green plantations, forestry, land reclamation, conservation of the natural and reserve fund, health of the population, etc. These indicators were discussed on 4 October 2013 at a meeting of the National Advisory Board (NAB) on Effective Public Finance Management, were further reviewed by the Interdepartmental Working Group, and later entered into a supervised directive of the Ministry of Finance.

In order to implement the State support of the PPB methodology for all oblast, rayon and oblast-significant municipal budgets during the third year of implementation, IBSER will:

- assist in developing proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation;
- help Ministry of Finance of Ukraine develop proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation; and
- prepare draft amendments to the joint orders of MOF and line ministries that approve the standard lists of budget programs and their performance indicators for all functions of local budgets.

Deliverable: Proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation developed
Timeline: October 2013 – September 2014

MFSI-II experts are continuing their work of improving the regulatory and legislative framework, which regulates implementation of Performance Program Budgeting for local budgets. The amendments are intended to ensure common approaches to a full-fledged transition to PPB of local budgets at all levels.

PPB-based planning of local budgets as the main and only method of budget planning and execution (rather than a pilot method) will start in 2014. Therefore, the effective documents will need to be developed, the procedures changed, and the rules of applying the PPB method must be implemented on a regular basis rather than as an experiment. Work has started to prepare changes to one of the key regulations of the Ministry of Finance, which stipulates the rules and procedure of PPB budgeting at the local level (MOF Order No.679 of 9 July 2013). The order approved the document forms to be used in the process of PPB-based formation and execution of local budgets, rules for compiling these forms, as well as the guidelines for participation of responsible implementers of budget programs in the budget process.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

MFSI-II experts continue their work of amending the regulations, which will provide for a full-fledged implementation of PPB budgeting for local budgets. The amendments should provide common approaches to the formation and execution of budgets at all levels and, in particular, to generation of reliable consolidated reports. Working consultations have been held with the specialists from the Ministry of Finance and the State Treasury Service of Ukraine.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

MFSI-II experts continue their work of improving the regulatory and legislative framework, which regulates implementation of the Performance Program Budgeting for local budgets.

The key vectors of further work were reviewed on 6 June 2014, at a meeting of the National Advisory Board on efficient public finance management. Also, discussed at the meeting were the proposals of MFSI-II experts with regard to amending the key document of PPB for local budgets, i.e., the Order of the Ministry of Finance of Ukraine dated 9 July 2010, No.679. The meeting participants approved the materials developed and noted that the proposals made by MFSI-II experts are formulated with due account for special features of execution of local budgets at different levels, as well as possibilities of the transition to a fully-fledged implementation of PPB planning and execution of local budgets at all levels.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 26 August 2014, the Ministry of Finance of Ukraine approved the Order No.836 "On Certain Issues of Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets." This Order incorporates in full the proposals made by MFSI-II experts towards improving the approaches to the Performance Program Budgeting of local budgets.

The Order regulates the main procedures and approves the documents, which ensure formulation of local budgets based on PPB. Among other things, it is stipulated that passports of budget programs and reports of their execution shall be compiled in an annual format. Standards are established for submission by key spending units of their summary results of the analysis of efficiency of budget funds; the procedure is settled for determining responsible implementers under budget programs, which are subdivided into subprograms etc. The form of a passport for a local budget program, report on its execution, and the rules for their generation are all approved in a new version.

The Order was enacted as of 10 October 2014.

See folder "Deliverables"

Deliverables: Drafts amendments to joint orders of the Ministry of Finance and line ministries that approve standard lists of budget programs and their performance indicators (if needed)
Timeline: October – December 2013

MFSI-II experts have developed amendments to the Standard Lists of budget programs and their performance indicators in the Education and Culture departments, approved by joint orders of MOF and line ministries.

MFSI-II experts have also developed amendments to the Typical List of performance indicators of local budget programs for the expenditures disregarded when determining the amount of intergovernmental transfers. The developed indicators characterize the impact from using the budget funds on the environment and population health.

The proposals for incorporating the amendments were sent to the Ministry of Finance.

Adoption of the proposed amendments will help reduce the number of budget programs in the respective departments and optimize their performance indicators.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Sub-task 1.1.3: Develop formats and procedures for treasury-based services of local budgets to improve the budget software used by the State Treasury; field-test these products within the local governments that have been a part of the pilot program

During the first and second years of project implementation, the MFSI-II experts have reviewed the existing reporting forms on execution of local budgets, which are compiled by the State Treasury of Ukraine. The analysis has shown that these reports need amending in the context of PPB budgeting, namely: it is necessary to take into account the special circumstances of execution of local budgets using the codes of program classification of expenditures and crediting of local budgets.

The special features in generation of reports according to PPB were brought for consideration of the members of the National Advisory Board on efficient public finance management and approved at the meeting of 27 April 2012. Based on the results of this work, the IBSER proposals for improving the reporting forms on execution of local budgets, which are compiled by the State Treasury Service of Ukraine, have been developed and submitted to the Ministry of Finance of Ukraine.

Proposals of MFSI-II experts were incorporated into the modification of forms of financial and budget reports on execution of local budgets approved by Order No.14 of the Ministry of Finance of Ukraine dated 16 January 2013.

The Order of the Ministry of Finance dated 25 November 2012, No. 1126 “On amending the Order of the Ministry of Finance of Ukraine of 30 January 2012, No. 60" approved amendments to the forms of budget reports on execution of local budgets, which incorporate the proposals made by MFSI-II experts with regard to improving the existing reporting forms on execution of local budgets.

IBSER will provide technical support for improving the formats and procedures of treasure servicing of local budgets. It will support the implementation of the preparatory work needed for introducing the generation of reports on the execution of local budgets based on the codes of program classification of expenditures and crediting of local budgets.

Within the third year of implementation, should amendments be made to the PPB methodology for local budgets, IBSER shall:

- carry out a new review of the existing reports on the execution of local budgets used by the Treasury and draft proposals with regard to their amendment in the context of PPB.
- prepare proposals for improving the procedures for the treasury servicing of local budgets. It will submit proposals with regard to such amendments to the legislative framework that defines Treasury functions.
- develop proposals for the requirements specification to improve the budget software used by the State Treasury and assist with its field-testing after installation in the pilot regions.

<u>Deliverables:</u> *The proposals for improving the existing reporting forms, as well as new forms for the treasury servicing of PPB-based budgets developed*
<u>Timeline</u>: *January – June 2014*

In the course of working consultations with the specialists of the Ministry of Finance and State Treasury Service of Ukraine conducted by MFSI-II experts, the ways were discussed of further improvement of the local budget execution reporting forms. Taking into account that generation of reports on execution of local budgets in the PPB format is scheduled to start in 2015, the MFSI-II experts will present their proposals in the second half of 2014.

<u>Accomplished</u> (see “Quarterly Report 01 January 2014 - 31 March 2014”)

MFSI-II experts completed work of improving the unified financial and budgetary reporting forms on execution of local budgets, which are compiled by the State Treasury Service of Ukraine.

This issue was discussed at a meeting of the National Advisory Board on efficient public finance management on 6 June 2014.

To implement the decision of the National Advisory Board, the MFSI-II experts finalized the budget reporting forms on execution of local budgets and prepared their proposals for making the appropriate amendments. The proposals take into account special features of execution of local budgets of different levels using the codes of program classification of expenditures and crediting of local budgets, as well as the standard program classification of expenditures and crediting of local budgets / provisional classification of expenditures and crediting of the local budgets, which are not using PPB.

The proposed amendments provide for assuring common approaches to the formation of reports on execution of local budgets at all levels.

The proposals have been submitted to the Ministry of Finance of Ukraine.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Deliverables: The proposals for improving the procedure for the treasury servicing of local budgets developed. The proposals with regard to amendments to the legislative framework, which defines Treasury functions developed (if needed)
Timeline: October – December 2013 and July – September 2014

Treasury execution of local budgets in the PPB format will start in 2015. The proposals prepared by MFSI-II experts during Year Two of the Project have already been approved.

See "Quarterly Report 01 July 2013 - 30 September 2013"

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Deliverables: The proposals for the requirements specification to improve the budget software used by the State Treasury developed
Timeline: October 2013 – September 2014

The proposals of MFSI-II experts for improving the Treasury servicing of local budgets when using PPB were discussed at a meeting of the task force at the Ministry of Finance on 25 December 2013. The meeting participants noted good results from pilot operation of the software by finance departments and from the State Treasury Service actions aimed at improving the relevant software.

This work would aid local governments in using the PPB methodology for formulating and executing local budgets, as well as generating transparent budget reports.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

The proposals of MFSI-II experts for improving the budget software have been incorporated when finalizing development of the software for the Treasury system and finance departments.
Further modifications to the requirement specifications will be developed concurrently with the proposals for improving the local budget execution reporting forms.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

MFSI-II experts have prepared and submitted to the Ministry of Finance their proposals for improving the reporting forms on execution of local budgets.

In the course of working consultations, these amendments were also coordinated with specialists of the State Treasury Service of Ukraine and used as a basis for improving the software used by the Treasury and finance departments.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

The proposals made by MFSI-II experts have been incorporated when amending the procedure of Treasury servicing of local budgets. The amendments have been approved by Order of the Ministry of Finance of Ukraine. In all forms of documents used in the process of Treasury servicing of local budgets, the use of codes of the typical program classification of expenditures and lending of local budgets has been standardized. Such amendments will ensure an unconditional finalizing of the software used by the Treasury and will contribute to improving the transparency in execution of local budgets.

Sub-task 1.1.4: Prepare and disseminate a PPB hand book

In 2011, MFSI-II experts prepared a *Modern Tools of Financial Planning* handbook, which contains the training, normative, and methodological materials needed for learning the methods and applying the practices of local budget planning based on Performance Program Budgeting. The methodology of financial justification of strategic documents and principles of financial analysis of investment projects are provided.

In 2011-2013, MFSI-II experts prepared and updated 3 versions of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook, which contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting method. This handbook reflects all the latest changes in the PPB legislation.

Should any significant changes be made in the methodological framework of Performance Program Budgeting for local budgets, this publication will be amended accordingly. An updated version of the Modern Tools of Financial Planning Handbook will be posted on the IBSER website and disseminated during PPB trainings.

Deliverable: The PPB Handbook improved due to changes in legislation (if needed), disseminated, and published on the website
Timeline: October – December 2013

In December 2013, MFSI-II experts prepared an updated fifth version of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook, which contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting method. This handbook reflects all the latest changes in the PPB legislation.

An electronic version of this handbook has been prepared for ease of use. Its use will help improve the knowledge of local-level specialists about the modern tools of financial planning. The electronic version of this handbook will be disseminated during PPB trainings for local offices of the State

Treasury and local finance departments.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Sub-task 1.1.5: Assess the need for additional PPB training in those municipalities that participated previously in the Municipal Budget Reform Project

IBSER will develop a questionnaire and conduct an analytical survey of the municipalities that participated in the Municipal Budget Reform Project, which will then be used for assessing the status of using the PPB methodology and the need for conducting special PPB training sessions for such municipalities (will be conducted within Sub-task 1.1.6).

Deliverable: An analytical memo describing the results of surveying the municipalities that participated in the Municipal Budget Reform Project
Timeline: January – March 2014

80 Ukrainian cities participated in the Municipal Budget Reform Project. According to the MOF Order #805 of 2 August 2010 "On Approving the Main Approaches to Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets," all oblast-subordinated Ukrainian cities should take part in the State experiment of PPB implementation. MFSI-II experts have delivered training and provided PPB consultations for these cities. All oblast-subordinated cities have been preparing their budgets in the PPB format on an experimental basis since 2011.

The participants of the Municipal Budget Reform Project only included six raion-subordinated cities, which are not participating in the experiment at this time. These are Trostyanets', Borshchiv, Buchach, Kivertsi, Kaharlyk, and Skvyra. To examine the status of PPB implementation and their willingness to collaborate, IBSER have prepared and sent out questionnaires to these cities, which will then be used to analyze of whether or not the specialists in these cities are in need of any further training and PPB consultations.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Deliverable: Special trainings for the municipalities that participated in the Municipal Budget Reform Project (if needed)
Timeline: April – June 2014

MFSI-II experts have analyzed the data of the questionnaires returned by the cities participating in the Municipal Budget Reform Project. The representatives of the towns Trostyanets' and Buchach expressed their wish to learn more about the PPB methodology and take part in trainings. IBSER forwarded methodological materials to these cities and is working with the municipal leaders to agree the training dates.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Sub-task 1.1.6: Train at least 8,000 budget officers from local finance departments, key spending units, as well as territorial departments of the Treasury

In order to efficiently implement PPB at the local level, it is necessary to improve the qualifications of the personnel of local finance departments, the specialists of the spending units and recipients of budget funds, as well as of the representatives of regional and local offices of the State Treasury. Thus, since the project launch, the MFSI-II experts have conducted a series of similar PPB trainings. Such trainings were delivered in all oblast centers for specialists of each region. Overall, 4,805 local-level specialists passed through this training since the start of the Project, including 4,278 women and 527 men (without the training under Sub-objective A.1).

At the regional level, during the third year of MFSI-II project implementation, IBSER will deliver a series of cluster trainings, which will cover more than 2,000 local offices of the State Treasury and local finance departments.

Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex
Timeline: October – December 2013 and July – September 2014

In the reporting period, in response to a commission from the Ministry of Finance, the MFSI-II Project experts launched a series of regional PPB trainings for specialists of the State Treasury Service of Ukraine. This effort is a logical continuation of Phase II of the experiment of PPB implementation for local budgets.

The first trainings were delivered in Crimea, the cities of Kyiv and Sevastopol, and the Kyiv, Chernihiv, Ternopil, Kharkiv, Zhytomyr, Lviv, Donetsk, Cherkasy, Odesa, and Zaporizhzhya oblasts. Participants included structural unit specialists of the State Treasury Service Principal and rayon offices and PPB implementation coordinators from each of the regions.

Regional training on implementation of the Performance Program Budgeting method of planning and execution of local budgets, the city of Kyiv 15 October 2013

A total of 969 local specialists were trained within the reporting quarter.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Experts of the MFSI-II Project continued delivering a series of regional PPB trainings for specialists of the State Treasury Service of Ukraine.

In the reporting quarter, the trainings were delivered in the Khmelnytskyi, Kherson, Mykolaiv, Dnipropetrovsk, Ivano-Frankivsk, Sumy, Chernivtsi, and Poltava oblasts. Engaged in the training were the specialists of the structural units of the Principal and raion directorates of the State Treasury Service and PPB implementation coordinators from each of the regions.

All in all, 627 local specialists passed through training in the reporting quarter, with 1,596 specialists trained since the beginning of Year III of the MFSI-II Project.

Regional training on implementation of the Performance Program Budgeting method of planning and execution of local budgets, the city of Mykolaiv 13 February 2014

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Experts of the MFSI-II Project completed delivery of a series of regional PPB trainings for the specialists of the State Treasury Service of Ukraine.

In the reporting quarter, trainings were conducted in the Zakarpatska, Kirovohrad, Vinnytsya, Rivne, and Volynska oblasts. Engaged in the trainings were specialists of structural units of the Principal and rayon offices of the State Treasury Service and PPB implementation coordinators from each of the regions.

All in all, 334 local specialists passed through training in the reporting quarter, with 1,930 specialists trained since the beginning of Year III of the MFSI-II Project. During the trainings, USG assistance in PPB was provided for 261 sub-national government entities.

Thanks to this effort, it is for the first time in Ukraine that Treasury servicing of all local budgets in the PPB format will be introduced, and the generation ensured of reports based on the new approaches in line with the European practices.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Sub-task 1.1.8: Provide advisory support to those local governments that have not been involved in the PPB pilot project

- During the first and second years, IBSER developed the existing local network of consultants who will help introduce PPB budgeting and will facilitate coordination between participants in the process. To implement the tasks of the second year of the project the consultants will collect, summarize, and submit for consideration by the Ministry of Finance the most important issues and promote the dissemination of recommendations for their resolution in the regions. To facilitate experience sharing among all the participants in the experiment and analyzing the progress of implementation of PPB budgeting, information from all the regions will be collected and processed on an ongoing basis. Best practices in PPB implementation will be highlighted on the MFSI-II website and in print publications.
- IBSER will continue supporting the website section "Topical PPB Issues: Expert Answers column," where visitors will be able to receive answers to their questions through interactive communication.

Deliverable: Annual experiment progress reports
Timeline: March 2014

According to a letter of the Ministry of Finance (dated 4 April 2013, No. 31-05030-12-8/10691 "On Implementation in 2013 of Phase II of the Experiment of PPB Implementation at the Local Level"), information was collected on the status and results of PPB implementation at the local level as of 1 January 2014. Based on these data, MFSI-II experts grouped and summarized the results of experiment implementation in 2013. Thus, the experiment participants approved nearly 43,500 budget programs, including 5,100 programs with indicators of economy of budget funds. According to their performance, savings of over UAH 790mn were generated.

The summarized information about the monitoring of the status and results of PPB implementation at the local level was submitted by IBSER for consideration of the Ministry of Finance.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Result/Deliverable: Running a column called "Topical Questions on PPB: Answered by Experts" on IBSER web-page

Timeline: monthly

A new set of questions (15 for the reported period) with experts' answers related to PPB has been placed on the site. In total, 189 answers to PPB-related questions have been prepared and posted on the website since the launch of the MFSI-II Project. The issues are regularly updated and relate to special circumstances of applying the Performance Program Budgeting methodology at the level of local budgets: providing clarifications with regard to the rules and procedures of filling out budget requests, compiling passports of budget programs, using the codifier of budget programs, and conducting a comparative analysis of the performance efficiency of budget programs.

See folder "Deliverables"

Task 1.2: Review the legislation and analyze the execution of the State and local budgets of Ukraine. Provide support to operations of Interdepartmental Working Group

Sub-task 1.2.1: Advisory support to the interagency working group in finalizing the methodology, and the laws and regulations needed

- IBSER will provide organizational support to the Ministry of Finance's Intergovernmental Working Group by organizing meetings and developing the relevant recommendations regarding PPB methodology implementation.

In 2011-2013, experts of the MFSI-II Project took part in nine meeting of the Interdepartmental Working Group. The meeting participants were considering the issues of amending the PPB methodology, including the following:

- improving the Standard lists of budget programs and of amending the relevant regulations;
- improving the Codifier of budgets programs, and building a transitional table from the Provisional Classification of Expenditures and Crediting of Local Budgets to the program classification of local budgets;
- matter of approval of budget programs by the participants of the PPB budgeting experiment;
- discussed the proposals of MFSI-II experts with regard to the topical issues of improving the treasury servicing of PPB-based budgets;
- set out the ways of speeding up the work of improving the software, which would allow automating the PPB-based planning of local budgets;
- focused on the topical issues of improving the treasury servicing of PPB-based budgets;
- reviewed the outcome of piloting the methodology of comparative analysis of budget program performance and ways of its improvement;
- discussed the progress of the experiment on introduction of components of the Performance Program Budgeting method.

Result: Meetings of the working group will be held on a regular basis
Deliverable: Developed recommendations
Timeline: November 2013, February 2014, May 2014, September 2014

On 4 October 2013, a regular meeting of the Interbudgetary Relations Task Force took place at the Ministry of Finance. The meeting was attended by specialists of the Ministry of Finance, State Treasury Service, line ministries, MFSI-II experts, and scholars.

The participants discussed the progress in implementing the 2013 National Action Plan, which includes the 2010-2014 Program of Economic Reforms.

The Task Force members supported the proposals by MFSI-II experts for improving the standard lists of budget programs, which were previously reviewed and approved at a meeting of the National Advisory Board. Special attention was given to the relevance of performance indicators of the budget programs primarily devoted to improving the environmental situation in the regions and improving the population's health.

A decision was made for the line ministries to amend the Standard Lists of budget programs in the Education and Culture sectors with due consideration for the proposals developed by MFSI-II experts. The group also decided to finalize and approve the performance indicators of the budget programs relevant for the state of environment and population health.

The proposed modifications would allow to:

- evaluate the effectiveness of use of budget funds and the quality of services provided in the department of Education and Culture;
- assess the impact of budget expenditures on improvement of environment and health of the population.

The above will help improve the transparency of local budgets and stimulate local governments to take actions aimed at improving the environmental safety and population health.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

On December 25, 2013, the Interbudgetary Relations Reform Task Force held its regular meeting in the Ministry of Finance of Ukraine. Representatives of the Ministry of Finance of Ukraine, State Treasury Service of Ukraine, branch ministries, MFSI-II experts and scientists participated in the meeting.

The task force members discussed and approved actions to improve software developed by the Ministry of Finance of Ukraine for the implementation of PPB at the local level. They also stressed on positive testing results for the software developed for financial authorities, and measures taken by the State Treasury Service of Ukraine for enhancing the automated system of treasury-based service of local budgets.

The representatives of the Ministry of Finance of Ukraine highly praised the work of MFSI-II experts in implementing PPB at the local level.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

On 23 April 2014, upon an invitation from the Ministry of Regional Development, Construction, and Housing and Communal Services (Minregion), the MFSI-II Project took part in a meeting of a group on developing proposals for fiscal decentralization and strengthening the material and financial foundations of local government.

Thus, a working group that includes MFSI-II Project is member, is preparing to introduce amendments to the Budget Code of Ukraine and is considering the first proposals made by the group's members. The group also includes representatives from the Verkhovna Rada Budget Committee, Ministry of Finance, line ministries, local governments, and others.

If the relevant Budget Code amendments are approved, this would contribute to conducting comprehensive reforms in the country. In particular, this applies to strengthening the financial sustainability of local governments and decentralization of public finance.

On 29 April 2014, upon the initiative of the MinRegion with participation of a representative of the MFSI-II Project, the second meeting was held of the working group for amending the Budget Code of Ukraine. The Working Group comprises members of the Verkhovna Rada Committee, Ministry of Finance, line ministries, local governments, and others. During the meeting, the participants considered concrete proposals for strengthening the financial capacity of local governments.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 5 September 2014, MFSI-II experts were invited by the Ministry of Regional Development, Construction, and Housing and Communal Services to take part in a meeting held at the Cabinet of Ministers of Ukraine to coordinate the amendments to the Budget Code with regard to ESCO contracts. The meeting was also attended by the EBRD experts, who were involved in the joint development of this legislative draft.

The MFSI-II experts have convincingly communicated to the specialists of the Cabinet of Ministers the importance of adopting the proposed amendments to the Budget Code, in particular those related to introduction of long-term budgetary obligations under energy performance contracts, which are necessitated by the need to:

- provide a legislative determination of the possibility for the head of a budgetary institution to make a contract, which envisages contractor's performance of works/provision of services in the current budget period without any respective expenditures having been approved in the budget, with the payment for such works/services to be made in subsequent budget periods after the fact of ensuring economy of funds for communal services and energy; and
- guarantee inclusion in the budgets of subsequent years of the funds needed to make payments under the contracts concluded as part of long-term obligations under energy performance contracts.

As the result of the discussion at the meeting, the participants have agreed the final revisions to the legislative draft for its presentation for consideration of the relevant Government committee.

The Municipal Finance Strengthening Initiative-II project and Ministry of Regional Developments finalized the legislative amendments and took part in a Working Group meeting **on 26 September 2014**. The meeting was also attended by the Ministry of Finance, Ministry of Economic Development, State Energy Efficiency Agency, and other stakeholders.

The participants approved in general the finalized legislative drafts and suggested some corrections. Based on the proceedings of the Interdepartmental Working Group, the amendments will be presented for approval at a Cabinet of Ministers meeting and then submitted to the Verkhovna Rada of Ukraine.

Adoption of the amendments to the main budget law drafted with project participation will make it possible for the first time ever to settle the legislative issues that prevent the implementation of energy service contracts. This will boost the energy independence of Ukrainian cities.

Sub-task 1.2.2: Help local governments assess draft laws affecting their revenues and resource allocation including the State Budget Bill to identify and mitigate potential risks for the local development

To implement this task, IBSER will:

- analyze the Budget Declaration for 2015;
- analyze the provisions of the draft legislation aimed at amending the revenue base of local governments;
- analyze the Budget Law for the respective year;
- analyze the Changes to the Budget Law for the respective year, and ensure suggestions are incorporated in the Law (if such changes are approved by the Verkhovna Rada);

- analyze the Changes to the Tax Code, land laws, and other laws related to local budgets, which could affect revenues and resources.

Result Analysis of the Budget Declaration for the next year is prepared and the suggestions to the document are accepted and incorporated in the text of the document
Timeline: April – June 2014

The Budget Committee of the Verkhovna Rada of Ukraine considered at its meeting **of 04 June 2014** the Draft Main Directions of the 2015 Budget Policy submitted by the Cabinet of Ministers of Ukraine. This document had been previously submitted for consideration of the Verkhovna Rada (Reg.No 4749 of 22April 2014), however, it was not approved in the first half of 2014. The MFSI-II Project experts have analyzed the above-mentioned Draft Decree.

The document envisages projected deficit of the State budget in GDP is to be retained at a level planned in 2014, i.e., 3.0%. Financing of deficit of the State budget General Fund, similarly to 2014, is hoped to be provided mainly at the expense of internal borrowing. Thus, in 2013, the planned internal borrowing for the General Fund was nearly 2.3 times higher than external borrowing; and in this year 2014, the planned internal borrowing for the General Fund exceeds external borrowing by only 1.2 times. Therefore, in 2015, similarly to 2014, efforts will need to be taken to bridge the gap between the deficit and the amount of capital expenditures and individual development expenditures.

Some options for development of the regions are stated as follows:

1) Improving the formal distribution of intergovernmental transfers between the State budget and local budgets with due account for the changes made to the tax and social legislation.

2) Ensuring balanced budgets of territorial communities and optimal ratios between the State and local budgets, and strengthening the revenue base of local budgets by means of revising the grounds for granting preferences based on sector in view of their effectiveness.

3) Integrating components of the medium-term budget framework into the local-level budget process.

Key Characteristics and Positive Trends:

1) Similarly to last year's document, the key macroeconomic projections of economic and social development are set, as well as individual estimates, such as: the share of GDP redistribution via the consolidated budget, ratio of deficit ceiling to the State debt and GDP etc.:

2) The need is stated for a comprehensive utilization of Performance Program Budgeting in the process of compilation and execution of local budgets;

3) Emphasis is made on the need of establishing the minimum wage and official salary (pay rate) for an employee of Tariff Class I under the Unified Tariff Schedule, taking into account the real status of the economy and budget's financial capacity, which would ensure their growth to be not below the consumer price index;

4) The need is stated of allocating the State investment resources for expanding and modernizing the infrastructure in the regions, which would support the maintenance of the current and creation of new jobs;

5) The need is also stated of taking steps to conduct proactive operations related to State debt management and liquidity of the Single Treasury Account, within the limits of the State debt ceiling as of the end of the budget period.

Accomplished (see “Quarterly Report 01 April 2014 - 30 June 2014”)

Deliverable: Analysis of the provisions of the draft legislation aimed at amending revenue base of local governments
Timeline: Ongoing process

Draft budget for the year 2014

Experts of the MFSI-II Project have prepared an analysis of the Draft Law of Ukraine "On the State Budget of Ukraine for the Year 2014" No. 3000 of 18 December 2013. Summing up the key features of the Draft Law, note should be made of the following strengths:

- social orientation; and
- improved transparency of budget planning.

There are, however, fiscal risks, including:

- State guarantees;
- privatization of State property;
- borrowing; and
- the need to revise certain items and eliminate the hidden deficit of local budgets.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Experts of the MFSI-II Project have prepared an analysis of the Draft Law of Ukraine "On Changes to the Tax Code of Ukraine" No. 4101a of 16 June 2014. Summing up the key features of the Draft Law, note should be made of the following strengths:

- increase of budget revenues due to taxation of passive incomes and introduction of a new tax on financial institutions
- improved procedure of taxation of dividends.

There are, however, fiscal risks, including:

- introduction of progressive scale of taxation of income in form of bank deposit interests;
- reduction of deposit volumes due to introduction of the new tax on financial institution.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 14 September 2014, the Cabinet of Ministers submitted to the Verkhovna Rada the Draft Law on amending the Budget Code of Ukraine (with regard to inter-budget relations reform) No.5078.

According to the Draft's Explanatory Note, one of the main objectives of the legislative draft is implementation of a new model of inter-budget relations and strengthening of the financial basis of local self-government. Thus, the legislative draft proposes a number of norms, which would allow bringing the provision of public services closer to end-users, improving the budget autonomy of local budgets, and strengthening their financial independence:

- Stimulating communities towards establishing associations
- Improving the Treasury servicing of budget funds
- Decentralization of spending powers
- Strengthening accountability for the formulation and execution of budgets in PPB format
- Timely approval of local budgets
- Preventing the risks of unjustified delays in obtaining approvals for local borrowing from IFOs.

Also, the legislative draft incorporates proposals made by MFSI-II experts, which, among other things, will remove barriers to a timely and complete performance by cities of their debt and guarantee obligations.

At the same time, the draft contains the legislative amendments, whose implementation would increase the likelihood of risks of worsening the budgeting process. First of all, this applies to servicing of budget funds at banking institutions. It is also suggested to exclude the single tax and tax on immovable property from the revenues of the development budget of local budgets and move these taxes to the General Fund. Withholding a portion of the personal income tax into the State budget is also introduced.

In general, the amendments proposed in the legislative draft introduce new models of financial

provision of local budgets and inter-budget relations, and present a significant step forward in implementation of local government reform and territorial organization of government. In the opinion of MFSI-II experts, the key positive features of the proposed amendments include the introduction of a mechanism of incentives for increasing the revenue base of local budgets. At the same time, the reduction of sources of development budget revenues, withholding part of the personal income tax to the State budget, and introduction of servicing of budget funds at banking institutions will all have a negative effect on the financial provision of local budgets and will not be conducive to development of local communities.

See folder "Deliverables"

Experts of the MFSI-II Project have analyzed the main provisions of the legislative draft "On Amending the Tax Code and Other Legislative Acts of Ukraine" and the Concept of Ukrainian Tax System Reform presented on the website of the Cabinet of Ministers of Ukraine.

The following key provisions have been identified:

- Reduction of the number of taxes from 22 to nine
- Unified accounting based on the financial reporting standards
- Expanding the area of applicability of the tax on immovable property
- Introducing the tax rate scale for passive income
- Introducing a local tax on sales of excisable goods at a 5% rate
- Imposing restrictions on transactions with single tax payers
- Raising the land tax rates from 1% to 3% and increasing the ceiling for land rent
- Introducing the spending controls by means of indirect methods
- Conducting inspections for correct accounting by tax bodies.

The objective of financial decentralization as declared by the Concept of Ukrainian Tax System Reform should be achieved by implementing reform of the personal income tax, crediting 10% of the proceeds from the enterprise profit tax to local budgets, expanding the tax base for the tax on immovable property, and introducing local excise taxes.

At the same time, the main risks of the proposed changes have been noted. In particular, the inclusion of non-residential properties into taxable objects would lead to an increased tax burden on small and medium-sized businesses, and introducing of a local excise tax would depress consumption and fuel growth of smuggled and counterfeit excisable products.

See folder "Deliverables"

Result: Performance of an analysis of the Budget Law for the respective year is prepared
Deliverable: Analysis of the Budget Law for the respective year
Timeline: December 2013

On 16 January, the Verkhovna Rada of Ukraine passed the Law of Ukraine "On the State Budget of Ukraine for the Year 2014."

Key Budget Parameters

UAH bn

	2013 (approved)	2014 (draft)	2014 (law)	Deviation of approved 2014 and 2013 indicators		Deviation of approved indicators and 2014 draft	
				+/-	%%	+/-	%%
Consolidated budget revenues	**488.2**	**499.0**	**501.9**	**13.7**	**2.8**	**2.9**	**0.6**
share of consolidated budget revenues in GDP	*31.0*	*30.2*	*30.4*	*-0.6*	*-2.1*	*0.2*	*0.6*
STATE BUDGET							
REVENUES	**381.2**	**392.4**	**395.3**	**14.1**	**3.7**	**2.9**	**0.7**
EXPENDITURES	**434.0**	**447.3**	**462.2**	**28.2**	**6.5**	**14.9**	**3.3**
Including development expenditures	*47.2*	*48.0*	*56.5*	*9.3*	*19.7*	*8.5*	*17.7*
Pension Fund of Ukraine	83.2	87.4	87.4	4.2	5.0	0.0	0.0
PROVISION OF CREDITS	**13.4**	**9.0**	**9.0**	**-4.4**	**-32.8**	**0.0**	**0.0**
REPAYMENT OF CREDITS	**12.1**	**4.4**	**4.4**	**-7.7**	**-63.6**	**0.0**	**0.0**
DEFICIT	**54.1**	**59.5**	**71.6**	**17.5**	**32.3**	**12.1**	**20.3**
State budget deficit in GDP	*3.4*	*3.6*	*3.6*	*0.2*	*5.9*	*0.0*	*0.0*
LOCAL BUDGETS							
REVENUES (without intergovernmental transfers)	**108.6**	**109.3**	**109.3**	**0.7**	**0.6**	**0.0**	**0.0**
State budget transfers into local budgets	118.9	128.3	132.7	13.8	11.6	4.4	3.4
REVENUES (with intergovernmental transfers)	**227.5**	**237.6**	**242.0**	**14.5**	**6.4**	**4.4**	**1.9**
EXPENDITURES (without intergovernmental transfers)	**233.9**	**234.9**	**239.3**	**5.4**	**2.3**	**4.4**	**1.9**
Funds transferred to the State budget	1.8	2.7	2.7	0.9	50.0	0.0	0.0
EXPENDITURES (with intergovernmental transfers)	**235.7**	**237.6**	**242.0**	**6.3**	**2.7**	**4.4**	**1.9**
CREDIT PROVISION	**0.2**	**0.0**	**0.0**	**-0.2**	**X**	**X**	**X**
CREDIT REPAYMENT	**0.1**	**0.0**	**0.0**	**-0.1**	**X**	**X**	**X**
DEFICIT	**8.3**	**0.0**	**0.0**	**-8.3**	**X**	**X**	**X**

The 2014 **nominal GDP** forecast of UAH 1,653bn served as the base for budget calculation. This indicator is 4.9% higher than the indicator used for 2013 budget formation. Also, it is 11.3% greater than the expected 2013 indicator.

The **State budget** revenues are stated at UAH 395.3bn, which is UAH 25.3bn or 6.8% more than the amount of revenues approved for 2013 (with amendments).

In view of a shortfall for the planned indicator of budget revenues in 2013 (by approximately UAH 25.0bn or 6.7% of the target according to the estimates made by IBSER experts), the 2014 annual plan was increased by 14.5% against 2013, which points to its significant overstatement.

Besides an overstated macroeconomic base for calculation of budget revenues, another factor of such an overstatement of the plan included the adoption and subsequent cancellation of the Tax Code provision with regard to tax exemption for the transactions of importing natural gas in the customs territory of Ukraine, which is contained in the final provisions of the draft. Let us recall that the Law of Ukraine of 19 December 2013, No.713 "On Amending the Tax Code of Ukraine with Regard to Rates of Certain Taxes," revoked the VAT exemption for import of natural gas. Due to this modification, given the planned procurement of about 40 bn cu m of gas at a reduced price ($268.6 per 1000 cu m), the budget had to additionally receive about UAH 17bn. At the same time, as early as 17 January 2014, the exemption was brought back by passing the Law of Ukraine No.727 "On Amending Article 197 of the Tax Code of Ukraine Regarding Exemption from the Value-Added Tax on the Transactions of Importing Natural Gas in the Customs Territory of Ukraine." However, the approved projected indicator of VAT for 2014 has not been adjusted for the amount of reintroduced exemption. Therefore, an overstatement of this indicator at least for the amount of reinstated exemption could be projected.

In addition, in the light of the 2013 trend towards reduction of imports, which decreased by 11.1% year-on-year in January through September 2013, and which is also expected in 2014, an increase in the import duty and excise tax on the goods imported in Ukraine by 12.9% and 24.1%, respectively, appears to be overstated by UAH 3.5bn to 4bn.

The State budget expenditures are planned at UAH 412.1bn *(UAH 410.7bn acc. to draft)*, which is 0.4% less than the 2012 plan. Also, **the development expenditures are reduced by 42.1%** or to UAH 40.6bn.

As usual, **nine key spending units of the State budget account for the majority of expenditures (84.8%)** (of the total 90 key spending units, 26 of which are local State administrations). These include:

- Ministry of Finance of Ukraine– 38.8 %
- Ministry of Social Policy of Ukraine – 21.6 %
- Ministry of Education and Science, Youth and Sport of Ukraine – 6.1 %
- State Motor Roads Agency of Ukraine – 3.9 %
- Ministry of Defense of Ukraine – 3.7 %
- Ministry of Internal Affairs of Ukraine – 3.7 %
- Ministry of Energy and Coal Industry of Ukraine – 2.4 %
- Ministry of Health of Ukraine – 2.4 %
- Ministry of Agrarian Policy and Food of Ukraine – 2.0 %

It is planned to increase the borrowing amount by 26.5% to UAH 135.6bn. The pace of debt repayment is somewhat slower at 23.0%.

This borrowing amount will be the highest in the last eight years.

According to the Explanatory Note, the Ministry of Finance estimates the 2014 **local budget revenues** (without transfers) at UAH 109.3bn, which is nearly the same as the plan approved by local councils for 2013.

The personal income tax revenues are estimated at UAH 71.1bn, which is 1.1% more than the 2013 plan. Given a growth in nominal GDP to UAH 1,653bn (by 11.3% vs. the 2013 forecast[1]) and increase in minimal wages by 8.1%, the estimate for the main source of revenues for local budgets is achievable in 2014. However, as **there are risks of an overstated forecast for the nominal GDP, this could also impact the achievement of the forecast for the personal income tax.**

According to the forecast, this tax will amount to 0.03% of the total local budget revenues (without intergovernmental transfers). Such a negligible amount confirms that **there is a pressing need to revise the approaches to taxation of immovable property**, as was reiterated by MFSI-II Project experts on numerous occasions.

The Ministry of Finance **projects a 34.2% growth in local taxes and fees of up to UAH 7.8bn**. Also, the single tax is the main item to provide UAH 7.1bn in revenues. **Such a forecast is realistic** thanks to the amendments introduced by the Tax Code of Ukraine.

According to the Ministry of Finance calculations made for the draft law, **the local budget expenditures** of the General Fund and Special Fund (without transfers) will amount to UAH 239.3bn, which is 2.1% more than the 2013 plan.

The most significant cuts **(by UAH 5.5bn) are made in the forecast of expenditures to be used for public administration**. According to the explanations, such a calculation has been made based on the norms with regard to the staffing of local governments and the population size and density of respective territorial units. At the same time, without significant administrative changes, these funds would be insufficient for financing administration bodies and the local communities will be forced to use their own funds for the administration apparatus. **About UAH 2.5 to UAH 3.0bn will be needed in addition to ensure operation of local administration bodies**.

The funds for medicines, bandaging materials, foodstuffs, and services (except utilities) are insufficient. Given inflationary expectations included in the draft, their deficit could exceed UAH 4bn.

In the structure of State budget transfers, **the equalization grant** at 47.5% has the highest share. It will increase by UAH 7.4bn or by 13.4%.

The share of **social protection subventions** increased by 2.2ppt and reached 45.1%. Also, in absolute terms, these subventions are planned at the amount of UAH 59.8bn, which is 17.6% more than the 2013 figure.

The share of capital subventions will be 2.1% vs. 3.3% according to the 2013 data, and their amount will reach UAH 2.8bn. At the same time, with the funds intended for financing the socioeconomic development programs and projects by the State Regional Development Fund, **the amount of State budget capital investments for development of the regions is increased by 21.1% or by UAH 1.1bn compared to 2013**.

Unlike the draft law, the approved version envisages a subvention to local budgets for repayment of the debt accrued due to difference in tariffs for the heat energy produced, transported, and supplied to the population, which emerged due to a mismatch between the actual cost of heat energy and the tariffs approved by or agreed to by competent government authorities at the total amount of UAH 2.9bn. **At the same time, local budgets will need at least UAH 5-7bn for this purpose**.

The amount of **intergovernmental transfers undistributed among the regions** is reduced to UAH 3.1bn for 2014 (they amounted to UAH 5.3bn in 2013).

According to the Explanatory Note, the amount of funds to be transferred to the State budget in 2014, for all local budgets the alpha coefficient of 1 will apply. In this way, **all funds will be sequestrated to the State budget in 2014.** According to MOF estimates, this would allow to increase by 72.2% the total amount of funds transferred from local budgets to the State budget estimated at UAH 2.7bn.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Result: Analysis of the Changes to the Budget Law for the respective year is prepared and the suggestions to it are incorporated in the Law (in case such changes are brought for consideration of the Verkhovna Rada of Ukraine)
Deliverable: Analysis of the changes to the Budget Law
Timeline: Depending on the date of law adoption

Experts of the MFSI-II Project have analyzed the amendments to the Law on the State Budget of Ukraine for the Year 2014 approved on 27 March 2014. The main characteristics of these amendments are included in the quarterly IBSER bulletin to be disseminated among more than 600 interested individuals and organizations.

The updated nominal GDP projection is most close to the International Monetary Fund estimates and stands at UAH 1,524.2 billion, which is UAH 128.8 billion or 7.8 % less than accounted for in the budget passed in January 2014. a portion of GDP re-distribution through the consolidated budget is also envisioned to go up by 1.0 p.p. up to 31.7 %.

The consumer price index was increased to 8.5 %, while the budget passed in January 2014 accounted for 4.3%.

The state budget revenues were reduced by UAH 22.4 billion or 5.7 %. The revenues reduction mostly concerned tax proceeds (by UAH 27.1 billion or 8.3 %), while the non-tax proceeds rose by UAH 5.5 billion or 8.7%. Such increase could be explained by the amendments to the tax law and in particular by the resumed duty on cash and cashless currency purchase and sale which is expected to bring in extra UAH 9.1 billion constituting 2.4 % of the total state budget proceeds.

It was proposed to have no rise in the subsistence minimum and the minimum wage throughout the year (in the previous revision of the budget it was envisaged to increase it starting from July 1 and October 1) and keep it unchanged at the level of January 1, 2014. The minimum wage was set forth in an amount of UAH 1,218 per month with the subsistence minimum of the same amount established for able-bodied persons.

The state budget expenditures were reduced by UAH 25.4 billion or 5.5 %. Most of the reduction dealt with the development expenditures which shrank by UAH 15.4 billion or 27.3 %. The Pension Fund

expenditures went down by UAH 3.6 billion or 4.1 %, which is explained by taking measures aimed to pump up its budget.

As compared to the indicators approved early this year, the internal borrowings were lifted by UAH 35.9 billion or 22.0 % (up to UAH 199.4 billion). Out of these funds, the amounts of government debt repayments were risen by UAH 14.3 billion, and also the government purchase of shares of additional issues by the public joint-stock company NAK "Naftogaz of Ukraine" by UAH 22.2 billion or threefold.

The privatization proceeds were reduced by UAH 2.4 billion, given that 50.0 % of the proceeds from privatization of fuel and energy sector facilities were excluded from the special fund.

The amount of government guarantees was decreased two fold – down to UAH 25.0 billion. Just like in the previous year, some of the government guarantees are to be given to the main budget spending units for attraction of loans for capital investments in excess of budget allocations.

The amount of inter-budget transfers provided from the state budget is determined at UAH 124.3 billion which is almost UAH 8.5 billion less than approved as of the year beginning.

In view of actual figures on fulfillment of the local budgets over 2013 and adjusted key social and economic development indicators, the calculation of equalization transfers to the local budgets were revised. Their amount was declined by UAH 2.2 billion and constitutes UAH 60.9 billion (in 2013, UAH 55.7 billion were disbursed in equalization transfers). Funds that are transferred to the state budget also reduced by UAH 0.7 billion and are equal to UAH 2.0 billion.

The amount of subventions on the national social assistance programs was decreased by UAH 5.0 billion, as compared to the indicators approved early this year. According to the provided explanations on the law draft, this was made due to a change in amounts of the social standards. Also, the funding of several government grants and subventions was abolished in a total amount of UAH 565.0 billion.

As compared to the law passed early this year, the regional development fund was narrowed by 71.3% down to UAH 1.0 billion. This is UAH 2.1 billion less than the compulsory amount of this fund which, under the Budget Code of Ukraine, should constitute at least 1 % of the projected amount of the general fund revenues of the draft State Budget of Ukraine for the respective budget period. At the same time, a separate UAH 500 million subvention was allocated for measures on the social and economic development of specific territories which used to be envisioned in an amount of more than UAH 1.0 billion as part of the state regional development fund.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Deliverable: Analysis of the Changes to the Tax Code, land laws, and other laws related to local budgets, which could affect their revenues and resources prepared
Timeline: Depending on the date of law adoption

Experts of the MFSI-II Project have prepared an analysis of the changes in the tax legislation, which come into effect as of 1 January 2014. The key innovations are as follows:

- tax on immovable property is introduced;
- VAT rate is reduced from 20% to 17%;
- the enterprise profit tax rate is reduced from 19% to 18%;
- the rates of excise tax on pure alcohol and alcoholic beverages raised.

The evaluation of results from implementation of these changes is provided in the Analytical Note.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Experts of the MFSI-II Project have prepared an analysis of the changes in the tax legislation, which were passed in the 1st quarter of 2014 and will come into effect as of July 1 2014. The key innovations are as follows:

- PIT: introduced taxation of passive incomes;
- VAT: cancelled reduction of the tax rate; introduced taxation of pharmaceuticals at rate of 7 % and VAT exemption for grain is extended;
- Immovable property tax: tax base is amended to include total area of the property rather than 'living area';
- the rates of excise tax on beer, on tobacco products, and on automobiles raised

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Sub-task 1.2.3: Help the GOU develop and review amendments to budget legislation that promote local level strategic planning and enable local governments to attract the private sector resources for the local infrastructure development projects;

- ***Help the GOU develop and review amendments to the Budget Code and sub-laws that:***
- ***Enable all creditworthy communities to have access to credit resources to fund their infrastructure development projects;***
- ***Regulate the process of adoption by local governments of responsibilities and financial obligations within PPP arrangements;***
- ***Enable local governments separating energy efficiency savings from the rest of the budget and using these savings to reimburse implementers of performance contracts.***

Striving to assist cities in attracting resources of the private sector for implementation of infrastructure improvement projects, MFSI-II experts conducted three working meetings with the Public Private Partnership Development Program (P3DP) as part of the Memorandum of Cooperation signed by the Institute for Budgetary and Socio-Economic Research and P3DP on 2 October 2012. MFSI-II experts took part in a roundtable to discuss the Draft PPP Development Strategy in Ukraine for 2012-2017 and the Action Plan on 6 November 2012.

In November 2012, in order to remove the said barriers, MFSI-II experts updated their proposals for amendments to the Budget Code of Ukraine. The prepared amendments to the Budget Code of Ukraine have been forwarded to all stakeholders for review.

If necessary, MFSI-II experts will prepare other drafts changes to the legislative and regulatory framework, will submit them for roundtables / meetings of NAB discussion, and will develop the strategy for promoting these changes.

Result: Development of draft changes to the legislation and regulations
Deliverable: draft amendments to the Budget Code (if needed); draft decrees of the Cabinet of Ministers (if needed); draft decisions of the State Treasury (regarding the issues of budget execution when implementing PPP projects) (if needed)
Timeline: October – December 2013

During two years of implementation of the MFSI-II Project, MFSI-II experts took part in five working meetings and sessions of a Working Group on legislative regulation of application of such a component of public-private partnership as energy service contracts. The MFSI-II Project experts participated in the said meetings upon invitation from the Coordinating Center for Implementation of Economic Reforms under the President of Ukraine. This Working Group has been set up to address the issue of legal foundations for operation of energy service companies and implementation of energy service contracts.

Representatives from the Ministry of Finance, Ministry of Economy, National Communal Services Regulatory Commission (National Commission), EBRD, and DTEK Company attended these meetings.

The Working Group considered, among other things, a Draft Law on amendments to the Budget Code of Ukraine. This Draft Law is needed to remove legislative barriers for introduction of energy service contracts. As a result, the meeting participants have supported inclusion into the legislative draft the proposals developed by the MFSI-II Project experts.

Within the third year of implementation, MFSI-II will take part in meetings and working groups on preparing other drafts changes to the legislative and regulatory framework of PPP implementation.

Result: Preparation and organization of a round table/ meeting of NAB for all interested parties
Deliverable: Recommendations of roundtable participants with regard to the legislative proposals developed under this task.
Timeline: March 2014

The Ministry of Regional Development, Construction, and Housing and Communal Services (MinRegion) invited experts of the MFSI-II Project and EBRD representatives to finalize amendments to the Budget Code with regard to legislative regulation of implementation of ESCO mechanisms in Ukraine. Work is currently in progress to coordinate the legislative draft with key government ministries, after which they will be presented to the Cabinet of Ministers of Ukraine.

Given the one-year budget period currently in existence in Ukraine and strict restrictions on obligations to be undertaken by spending units limited to the approved single-year expenditures, the amendments to the Budget Code developed with participation of MFSI-II Project experts will ensure:

- legislative designation of the possibility of making a contract by the head of a budgetary institution, which contract will provide for implementation by the contractor of works/provision of services in the current budget period without appropriate budget allocations, with their payment to be made in subsequent budget periods after the fact of achieving savings in expenditures for communal services and energy;
- guarantees of inclusion into budgets of subsequent periods of the funds needed for making payments under the contracts made under long-term obligations as part of energy service contracts;
- setting the procedure of annual assumption by long-term obligations under energy service contracts of the status of budget obligations only within the amount of actually achieved economy (therefore, the existing systems and procedures with regard to budget obligations will not be breached).

As stated above, approval of amendments to the main budget law developed with participation of MFSI-II Project experts would allow for the first time to settle the problem issues preventing from implementation of energy service contracts at the legislative level. This will give a boost to further reduction of energy dependence of Ukrainian cities.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Sub-task 1.2.4: Help local governments assess draft legislation affecting the local development such as Community Associations Bill and Regional Development Bill and suggest amendments with a focus on strengthening local revenues

- IBSER will review the draft legislation affecting local development and suggest amendments with a focus on strengthening local revenues (if an administrative and territorial reform is implemented, the said proposals will take the aspects of a new State system into consideration);

The MFSI-II Project experts took part in a working meeting on 17 February 2012, chaired by Anatoliy Blyznyuk, the Minister of regional development, construction, and housing and communal services of

Ukraine. Discussed at the meeting were the main directions and priorities of implementation of the local government and regional development reform. MFSI-II experts reviewed the provisions of the draft Law of Ukraine "On Associations of Territorial Communities" No.9590 of 14 December 2011 with regard to the financial support to associated communities. Conclusions and proposals were prepared and forwarded to all stakeholders in 22 February 2012. After this, the proposals were considered at the roundtable meeting at the Committee on State Building and Local Government of the Verkhovna Rada of Ukraine on 12 March, 2012.

MFSI-II experts have reviewed the following:

- the Decree of the Verkhovna Rada of Ukraine dated 7 February 2012, No.4350-VI directed to send for the repeated first reading the draft Law of Ukraine on the foundation of the State regional policy, which was registered by the Verkhovna Rada on 1 June 2010, under No.6462.
- the Cabinet of Ministers of Ukraine Decree of 21 March 2012, No. 312 "On Approving the Procedure of Using in 2012 the Assets of the State Regional Development Fund."
- the Cabinet of Ministers of Ukraine Decree of 4 July 2012, No. 656 "The Issues of the National Regional Development Fund
- the Law of Ukraine "On the State Budget of Ukraine for the Year 2013" part of the formation of the Regional Development Fund.
- the Resolution of the Cabinet of Ministers of Ukraine of 23 January 2013 No. 30 which amended the Procedure for preparation, evaluation, and selection of the investment programs/projects, which can be implemented at the expense of resources of the State Regional Development Fund.
- the Cabinet of Ministers of Ukraine issued Ordinance of 20 March 2013 No. 149-r "Certain Issues of Utilization of State Capital Expenditures in 2013."
- the Decree of the Cabinet of Ministers of 14 August 2013 No. 576 amended the Procedure of using the resources of the State Regional Development Fund approved by Decree of the Cabinet of Ministers dated 4 July 2012, No.656 "The Issues of the State Regional Development Fund."

Deliverable: The proposals based on the analysis findings prepared
Timeline: Ongoing process
Result/ Deliverable:

The Law of Ukraine "On the State Budget of Ukraine for the Year 2014" establishes a Regional Development Fund of UAH 3.5bn for financing medium- and long-term programs and projects of socioeconomic development of the regions. This complies with the Budget Code standard, which states that the amount of the State Regional Development Fund should equal at least 1% of the estimated amount of General Fund revenues of the Draft State budget of Ukraine for the respective budget period.

In the period under review, there were no changes to the procedure of preparation, evaluation, and selection of the investment programs/projects, which could be funded at the expense of the State Regional Development Fund, and the procedure of using the resources of the State Regional Development Fund.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

On 27 March 2014, amendments were introduced to the Law of Ukraine "On the State Budget of Ukraine for the Year 2014," which had an impact on the Regional Development Fund. Therefore, compared to the law approved at the beginning of the year, it was cut by 71.3% to UAH 1.0bn. This is contrary to the provision of the Budget Code of Ukraine, according to which the amount of the State Regional Development Fund must not be lower than 1% of the estimated amount of revenues of the General Fund of the Draft State Budget of Ukraine for the respective budget period. Based on this provision, the State Regional Development Fund should have amounted to UAH 3.1bn. The said amendments were made as part of strict economy measures.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

- IBSER will review the legislative changes aimed at financial support of regional development, in particular, for establishing a Regional Development Fund, and prepare its proposals intended for strengthening the financial resources of local governments.

Deliverable: The proposals based on the analysis findings prepared (if changes are approved)
Timeline: April – June 2014

According to the Law of Ukraine "On the State Budget of Ukraine for the Year 2014" (with revisions), the Regional Development Fund was approved at the amount of UAH 1.0bn. However, these funds were unused in the first half of the year, and their distribution by site is still to be approved. Also, there were no changes made to the main principles of accumulation and use of the State Regional Development Fund.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Task 1.3. Implementing FARA Mechanism in the Budget Sphere at the National and Local Levels

Contributing to the enhancement of international technical aid procedures and mechanisms in Ukraine, MFSI-II experts will help USAID to identify potential opportunities for implementing FARA mechanism in the budget sphere at the national and local levels. The experts will:

- review the current budgetary process and legislative framework governing the budgetary process with regard to the opportunity of applying FARA mechanism in the budget sphere;
- analyze in detail and examine USAID rules and procedures and possible experience of international organizations in implementing FARA mechanism in the budget sphere (including possible experience of other countries);
- provide recommendations of how to realize FARA mechanism in the budget sphere within the effective laws.

When the positive results on possible FARA implementation in the budget sphere are received, MFSI-II experts will: (i) develop possible financing road maps for implementation, considering the requirements of the Ukrainian budgetary process; (ii) follow legal changes which may concern it; (iii) provide recommendations on changes (if needed and positive results of possible implementation of FARA mechanism are received) to be made to legal and regulatory acts to implement FARA mechanisms in the budgetary sphere.

Sub-task 1.3.1.: Assessment of opportunity of implementing FARA mechanism in the budget sphere. Provide based recommendations.

Deliverable: Assessment Report
Timeline: January 2014

MFSI-II experts have prepared an Assessment of opportunity of implementing FARA mechanism in the budget sphere.

According to the assessment results, the key feature of the FARA mechanism consists in that USAID shall reimburse the funds for implemented projects within the framework of this mechanism only upon the fact of completion of works / provision of services. Also, development of a clear action plan for

application of such a mechanism in Ukraine must be preceded by designation of the concept of the Host Country Implementation Unit (HCIU), as recipient of funds of such reimbursements according to Ukrainian law. Specifically, it needs to be decided of whether this should be a key spending unit, which is implementing the project, or a government authority, which is approving the budget used for the upkeep of the abovementioned key spending unit.

The designation of this concept will govern all subsequent procedures to be undertaken as part of the FARA mechanism and various risks of applying such a mechanism will emerge.

Also, in order to use the FARA mechanism, certain amendments are needed to be introduced to the Resolution of the Cabinet of Ministers dated 15 February 2002, No.153 "On the Procedure of Attracting, Using, and Monitoring of International Technical Assistance." Such amendments are needed for several reasons.

Firstly, it is necessary to define in the said Resolution that the principle of targeted use of funds of international technical assistance shall not apply in the case of using the FARA mechanism. At the same time, the Resolution must include a condition for the provision of international technical assistance in the form of compensation for the costs incurred, namely, based on the results of completion of certain phases of project implementation according to the FARA mechanism as stipulated by the grant agreement.

Secondly, it is necessary to establish that the need for accounting of the used funds, which are provided as part of international assistance, shall not apply to the reimbursement funds, which are received as part of the FARA mechanism. Such accounting is not required when the FARA mechanism is used, since it is based on reimbursement of the costs already incurred and it does not track the use of reimbursed funds after they are received.

In addition, standard contracts will need to be designed to be concluded under the FARA mechanism, which would take into account the requirements of both Ukrainian law and USAID.

Some difficulties in application of the FARA mechanism could emerge when selecting an investment project. This is due to the fact that Ukraine is currently lacking a fully-fledged system of public investment planning for a medium term. Therefore, when developing a project, there are no guarantees that its implementation would be supported through allocation of budget funds during the given or subsequent budget period.

To minimize this risk it is possible to introduce a preliminary conclusion of a Memorandum of Intent between USAID and the relevant key spending unit / Ministry of Finance (local finance authority). Such a Memorandum could also serve as the basis for including of project implementation expenditures in the budget. This issue could be regulated in respective instructions on completion of budget requests. A contract, on the other hand, could be concluded in case of availability of design and estimate documentation and the funds for implementation of the respective project in the respective budget.

When implementing new activities, a government authority must confirm to USAID that the respective budget has sufficient resources for the stated objectives. This would require conducting an analysis of budget sufficiency and audit of trustworthiness of the budget indicators supplied by a prospective project recipient to USAID. Taking into account a rather low personnel capacity and absence of methodology, it is advisable that such an analysis should be conducted by a body authorized by USAID (e.g., as part of respective project).

There are also individual reservations with regard to implementation of projects based on the FARA mechanism directly by USAID without establishing a distinct project.

Thus, under the current legislation, when providing international technical assistance, it is imperative that a project/program implementer is designated. In this case, an implementer must be an entity other than donor, recipient or beneficiary.

Therefore, were projects under FARA mechanism to be implemented directly by USAID without establishing a separate special project, amendments will need to be introduced to the abovementioned Resolution, in particular, with regard to the determination that either donor or recipient could act simultaneously as project implementer, and by modifying respective individual procedures in the course of project's State registration.

In this way, were any projects under FARA mechanism to be realized directly by USAID, the number of the required "State registrations" of international technical assistance will increase to the number of individual projects, for which it is planned to provide reimbursement under FARA mechanism. This issue will be especially relevant for local projects.

One of the ways of resolving this issue could involve conclusion of framework tripartite agreements between USAID, respective local authorities, and the Government. For example, such agreements could relate to that the Government will be providing State budget subventions to local budgets for implementation of investment projects with subsequent reimbursement of the costs incurred on the condition of project completion. The said approach will require developing a template of the relevant agreement and a normative-legal act to legitimize it according to Ukrainian law.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Sub-task 1.3.2.*: Development of possible financing road maps for implementing FARA mechanism in the budget sphere.

Deliverable: the developed financing road maps
Timeline: January - March 2014

The key legislative changes required for implementation of the FARA mechanism in the budgetary sphere are described in a study carried out under Subtask 1.3.1.

In particular, Resolution No.153 of the Cabinet of Ministers of Ukraine dated 15 February 2002 "On the Procedure of Attracting, Using, and Monitoring the International Technical Assistance" will have to stipulate that the principle of targeted use of the funds of international technical assistance shall not apply when the FARA mechanism is used. At the same time, the above Resolution will need to include the condition of provision of international technical assistance in the form of reimbursement for the incurred costs, namely, based on the results of completion of certain phases of project implementation under FARA mechanism as stated in the grant agreement. In addition, the said Resolution will have to establish that the need of accounting any unused funds provided as part of international assistance shall not apply to the reimbursement funds received under FARA mechanism.

It is necessary to regulate in the legislation the possibility to transfer the reimbursement funds to be received under FARA mechanism from the General Fund to the development budget (in case of local budgets).

Also, the abovementioned study states that it is necessary to develop standard agreements to be concluded under FARA mechanism, which would take into account the requirements of both Ukrainian law and USAID. Besides, said agreements will have to envisage the norms, which would ensure the accountability of the key spending unit, which will be implementing the project, for its quality and timely implementation if the reimbursement funds are remitted to the budget rather than directly to the respective key spending unit. In this case, it will be important to list the conditions for partial reimbursement and/or termination of reimbursements. The said issue will have to be settled in the respective agreement on the provision of international technical assistance under FARA mechanism.

In addition, the study suggests considering the advisability of concluding a preliminary memorandum of intent when using the FARA mechanism between USAID and respective key spending unit / Ministry of Finance (local finance authority). This could improve the likelihood of allocating budget funds for implementation of a respective project if use of the FARA mechanism is planned with regard to a project, which requires preliminary development. The agreement, on the other hand, could be concluded with availability of the design and estimate documentation, and the funds for implementation of the respective project in the respective budget.

The study lists the main modifications to the abovementioned Resolution of the Cabinet of Ministers

of 15 February 2002, No.153 if projects under FARA mechanism are to be implemented directly by USAID without engaging a special project. In particular, with regard to the determination that both donor or recipient could act simultaneously as project implementer, and adjusting certain individual procedures related to State project registration.

In addition, according to the said Resolution, if projects under FARA mechanisms are to be implemented directly by USAID, the number of required "State registrations" of international technical assistance will increase to the number of individual projects, for which reimbursement under FARA mechanism is to be provided. This issue will be especially relevant for local projects. One of the ways to address this issue could involve a conclusion of framework tripartite agreements between USAID, respective local governments, and the central Government. This approach will require development of a template for the respective agreement and a normative-legal act to legitimize it according to Ukrainian law.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Sub-task 1.3.3.*: Provision of recommendations on changes (if needed) to legal and regulatory acts to implement FARA mechanism in the budgetary sphere.

Deliverable: the recommendations (if needed) on legal and regulatory acts
Timeline: March 2014 - September 2014

* Carrying out the sub-tasks 2-4 depends on positive results on possible implementation of FARA mechanism, Assessment Report defined by the Sub-Task 1.

Sub-objective A.1: Ensure institutional sustainability of the PPB training program(s).

Sub-task A.1.1: Conduct a study of the training centers that can offer PPB training sessions and methodological support to facilitate the introduction and effective application of PPB at the local level; identify those centers that are capable and interested in conducting PPB training sessions and providing methodological support on a regular basis

According to the Project Work plan, IBSER had to start its selection of and collaboration with the Centers in 2012. In a timely manner, IBSER selected post-graduate educational institutions, which are capable of and interested in delivering PPB training sessions. Training centers were selected in the Kirovohrad, Odesa, Chernivtsi, and Zakarpatska oblast and in the city of Kyiv.

With IBSER's support, these organizations will develop and adopt the PPB training curriculum and materials and will conduct PPB training sessions to support the introduction of PPB at the local level. MFSI-II experts will organize and deliver PPB trainings for specialists of these organizations.

Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex
Timeline: October – December 2013

In collaboration with the Kirovohrad Center of Retraining and Qualifications Enhancement, MFSI-II experts held a training on practical PPB implementation on **2 October 2013**. On **10 October**, a similar event was held at the Zakarpatska Regional Retraining and Qualifications Enhancement Center, the first training at this location. Participants included heads of budgetary organizations and institutions, and a training-of-trainers approach was used to build the capacity of local PPB specialists who would go on to train others.

These activities completed the first series of training for specialists of the selected training centers. The trainees were introduced to the theoretical foundations of PPB, instructive materials, and practical aspects of its application in accordance with the methodology documents developed by the Ukraine Ministry of Finance. This develops a practical expertise of delivering PPB trainings, which will subsequently enable local government staff to acquire the knowledge and skills required for effective PPB implementation.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

According to the Memorandum of Cooperation with the Kyiv City Retraining and Qualifications Improvement Center, MFSI-II experts conducted an advanced training devoted to practical aspects of Performance Program Budgeting **on 20 February 2014**. The training participants were familiarized with changes in the PPB legislation, special conditions in the formulation of budget program passports, and implementation of a comparative analysis of budget program performance.

This event has launched a new series of training workshops for specialists of the selected training centers, who will be subsequently delivering PPB training sessions.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Sub-task A.1.2: Help those training centers to develop a PPB training curriculum and PPB training materials and to conduct at least 50 PPB training sessions for relevant GOU officials

IBSER will hand over the PPB Handbook developed under Sub-task 1.1.4 to the selected training centers and will assist with the PPB training curriculum, as well as conduct at least 50 PPB training sessions with the specialists of such training centers. During the third year of project implementation, MFSI-II experts will deliver at least 30 PPB training sessions with the specialists of such training centers.

Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex
Timeline: January – June 2014

On 29 October 2013, specialists of the Chernivtsi Regional Retraining and Qualifications Enhancement Center conducted their first PPB training independently. The training was attended by the staff of central government offices, local governments, State-owned enterprises, institutions, and organizations.

Similar training was conducted at the Kirovohrad Regional Retraining and Qualifications Enhancement Center on **28 and 29 October 2013**. A focused short-term seminar with the heads and specialists of the oblast and raion finance directorates was held at the Center.

On 13 December 2013, as part of the Memorandum of Cooperation with the Kyiv City Retraining and Qualifications Enhancement Centers, the MFSI-II experts delivered training on the methodological foundations of PPB. The training was conducted under the professional qualifications enhancement program for public servants of categories V through VII.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

On 31 January 2014, as part of implementation of the Memorandum of Cooperation with the Kyiv City Center for Retraining and Qualifications Improvement, the MFSI-II experts delivered training on methodological foundations of PPB. The training was conducted according to the professional curricula of qualifications improvement for public servants of categories V-VII.

On 19 February 2014 and 24 March 2014, specialists of the Chernivtsi Regional Center for Retaining and Qualifications Improvement conducted regular PPB training session. The training was attended by public servants and local government officials.

Similar trainings were held at the Kirovohrad Regional Center for Retraining and Qualifications Improvement on **4-5 February 2014, 18-19 February 2014, and 11-12 March 2014**. The Center held topical seminars for local government officials.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

On 18 April and 11 June 2014, to implement the Memorandum of Cooperation with the Kyiv City Retraining and Qualifications Advancement Center, MFSI-II experts delivered training for trainers of professional courses. The trainings on the topic of *Methodological Aspects of Performance Program Budgeting* were delivered under the program of qualifications enhancement for public servants.

On 16 and 27 May 2014, specialists of the Chernivtsi Regional Retraining and Qualifications Advancement Center delivered the next regular PPB trainings. The trainings were attended by public servants and local government officials.

Similar training was conducted at the Zakarpatska Oblast Retraining and Qualifications Advancement Center on **16 May 2014**. A topical seminar on *Controls over Compliance with Budget Legislation* for public servants and local government officials was conducted at the Center.

On 7-11 April and 2-6 June 2014, seminars under professional program *Budget and Finance Management at the Regional Level* were delivered at the Kirovohrad Regional Retraining and Qualifications Advancement Center. Village and settlement mayors and secretaries of village and settlement councils passed through training. Additional practical sessions on the topic of *Performance Program Budgeting Method of Formation and Use of Local Budgets: Methodological and Practical Aspects* were arranged for the participants.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 11 and 12 September 2014, MFSI-II experts delivered two trainings on PPB for local-level specialists at the Zakarpattya Regional Retraining and Qualifications Enhancement Center. The training participants were familiarized with the recent changes in the PPB legislation, special features in the formulation of passports of budget programs, and making a comparative analysis of efficiency of budget programs.

This event is intended for the development of practical experience of delivering PPB trainings for specialists of the Regional Centers, which will subsequently allow the local government staff to acquire the required knowledge and skills of effective PPB implementation at the local level.

As part of collaboration with the Chernivtsi Regional Retraining and Qualifications Enhancement Center, trainings on practical PPB implementation took place on **17 and 18 September 2014**. MFSI-II experts delivered training for the specialists who will subsequently be delivering training sessions on PPB, as well as for heads of government-funded organizations and institutions from the Chernivtsi oblast.

The training participants were introduced to the theoretical foundations of PPB, directive materials and practical aspects of its applications in accordance with the methodological documents developed by the Ministry of Finance of Ukraine.

On 24 September 2014, specialists of the Chernivtsi Regional Retraining and Qualifications Enhancement Center independently conducted a scheduled PPB training. The training was attended by public servants and local government officials.

\These trainings continue implementation of the MFSI-II Project tasks related to ensuring institutional sustainability of PPB training programs. Such practices will help introducing the PPB methodology at the training centers, which will be conducting an ongoing PPB training.

On the whole, as part of collaboration with the Training Centers (*Sub-task A.1.1 and Sub-task A.1.2),* 375 local specialists were trained in the reporting quarter, including 348 women and 27 men. Since the beginning of Year 3 of MFSI-II Project implementation, this training was provided to 977 local specialists, including 881 women and 96 men.

See folder "Deliverables"

Objective B: Develop and introduce financial practices that foster energy efficiency in 15 selected cities

Task 2.1: Assist the cities in introducing an effective system of managing energy savings in the public sector

- IBSER will improve the unified methodology developed during the first year of project implementation and will select four Ukrainian cities for the third year of the project. IBSER will coordinate selection with Public Private Partnership Development Program and Developing Initiative for Advocating Local Governance in Ukraine (DIALOGUE).
- To assist the cities in developing well-founded energy efficiency programs, IBSER will update a system of monitoring of energy expenditures based on PPB method for the selected four cities, which is based on similar system developed for the cities selected for the first and second year of the project. In order to implement this system and based on the experience of MFSI-II Project accumulated in the first and second year of implementation, IBSER will update the training materials on implementation of the said system and will conduct training for specialists of key spending units in the four cities selected for its application.

During the first and second years of project implementation, the MFSI-II experts selected 11 Ukrainian cities (6 cities selected in 2012, 5 cities - in 2013). The total amount of loans granted by NEFCO is 182.9 million. These financial resources of the city directed at implementing energy efficiency projects. Implementation of all projects will have a significant social, economic and ecological impact for cities and reduce CO_2 emissions by 4499,6 tons per year.

MFSI-II experts have analyzed the energy expenditures of municipal budgets for heating, electricity, and natural gas in 2008-2011 and gave recommendations for the project cities.

Accomplished (see "Quarterly Report 01 January – 31 March, 2013").

MFSI-II experts prepared their assessments of the creditworthiness of the cities and made the relevant conclusions. Creditworthiness conclusions contain, among other things, a review of the sources of revenues of municipal development budgets, structure of expenditures, which reflects municipality's ability to allocate resources for the development needs etc.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012").

MFSI-II experts updated the system for monitoring energy-related budget expenditures for the selected cities. The new system has been brought in conformity with the latest changes in the Ukrainian budget legislation. Also, the system has been streamlined by reducing the number of indicators it contains.

Accomplished (see "Quarterly Report 01 March – 31 July, 2013")

Based on an updated system of monitoring and evaluation of efficiency of budget expenditures for utilities and energy (based on the Performance Program Budgeting method), MFSI-II experts have updated the respective training materials and presented it on the seminar "Financial Mechanisms of Improving Energy Efficiency in the Budgetary Sphere".

Result/Deliverable: Four Ukrainian cities for the third year of the project are selected using the developed unified methodology
Timeline: October – December 2013

The selection of cities for participation in the third year of the MFSI-II Project has been conducted according to an improved version of the selection methodology developed in the first year of the Project.

Based on the competition results, the cities of Kyiv, Luhansk, Sievierodonetsk, Kamyanets-Podilsky, Slavutych, Eupatoria and Kryvyi Rih have been selected and the Memoranda of Cooperation have been concluded with these cities.

The issues of energy efficiency and energy saving are appropriately reflected in the policies of respective city councils of the selected cities. For example:

- a municipal energy saving program for 2012-2016 approved in Kyiv;
- energy efficiency and energy saving programs for 2011-2015 are being implemented in Luhansk and Sievierodonetsk, also Sievierodonetsk has a municipal energy plan for 2011-2015;

The cities must not only strive to improve their energy efficiency, but should also undertake practical energy saving activities/projects. Therefore, the existence of such projects was one of the criteria in the city selection. All the chosen cities meet this criterion, for example:

- projects "Modernization in Municipal District Heating - demand management" and "Projects in the field of street lighting of Luhansk city: modernization of street lighting using energy efficient technologies and alternative energy sources"(Luhansk);
- projects "Thermal rehabilitation in budgetary institutions of Kyiv city" (Kyiv), and others.

Collaboration of the cities with the MFSI-II Project will help the cities to improve their energy efficiency, will facilitate establishment of an effective energy saving system (through development of a system for monitoring of energy expenditures), and provide financial incentives for energy saving in the budgetary sphere. The participation of city representatives in the seminars, working meetings, and other events organized by the MFSI-II Project will create opportunities for experience-sharing and for learning from the best domestic and international practices of improving the energy efficiency at the local level.

Accomplished (see "Quarterly Report 01 September – 31 December, 2013")

Continued collaboration with the Year Two project cities.

With the advisory support provided by the MFSI-II Project, the city of Lutsk received approval from the Ministry of Finance of Ukraine with regard to the amount and conditions of a loan for financing the Implementation of Energy Saving Activities in the Lutsk Municipal Budgetary Institutions investment project.

The project's objective is the implementation of energy saving activities in six public buildings in the city of Lutsk, including schools, children's educational institutions, and one city hospital.

The realization of the project includes a comprehensive set of energy

efficient activities, namely:

- replacing windows and doors, and insulating roofs and external walls;
- modernizing lighting systems;
- heat insulation etc.

After completing all of the activities, heat energy savings are expected to amount to 1275,4MW per year, electric power 94.1MW per year, and an aggregate CO2 emissions reduction of 427.1 tons per year.

The successful completion of the Implementation of Energy Saving Activities in the Lutsk Municipal Budgetary Institutions project will save UAH 1 million of public funds per year and will improve the level of comfort and state of health of both adults and children.

The project is one example of how the partnership between the MFSI-II project and the city of Lutsk in this field will significantly and positively affect the municipality's socioeconomic and natural environments.

Collaboration with the Year Three project cities.

MFSI-II experts provided methodological and advisory support to the city Kamyanets'-Podilskyi in drafting the required resolutions of the City Council and amending the municipal budget. Experts of the MFSI-II Project have assisted the city of Kamyanets'-Podilskyi to obtain an approval of borrow from the Ministry of Finance obtained approvals from the Cabinet of Ministers of Ukraine for issuing its local guarantees for the city's energy performance project. The overall goal of the DemoUkrainaDH Project in the city of Kamyanets'-Podilskyi is the modernization and improved reliability of service of its district heating system, reduction of energy intensity, and improved quality of heating services to citizens through the implementation of innovative solutions.

The Project is designed to upgrade the district heating system, viz., introduce 22 individual heating points, complete with implementing energy saving activities in buildings.

The Project will have significant economic (total gas savings of 641,700 m3/year), environmental (CO2 emissions cut by 2,240 metric tons per year or by 30%), and social (balancing out the heating system and restoring hot water supply) impacts.

Therefore, implementation of the Project will help reduce harmful emissions in the air thanks to reduced consumption of fossil fuels including gas, which is a priority for Ukraine in general, as well as improve the quality of service provision to citizens.

MFSI-II experts have analyzed the energy expenditures of four selected cities (Slavutych, Luhansk, Kamyanets'-Podilskyi, and Kryvyi Rih) in 2010-2013.

The analyzed data indicated that heating (KEKV 2271), water supply and water removal (KEKV 2272), electric power (KEKV 2273), and natural gas (KEKV 2274) increased or decreased depending on specific city. For example, such cities as Slavutych and Luhansk had their expenditures for utilities and energy increased 1.5 and 1.2 times, respectively, in 2011-2013 (see Chart 1 and Chart 2).

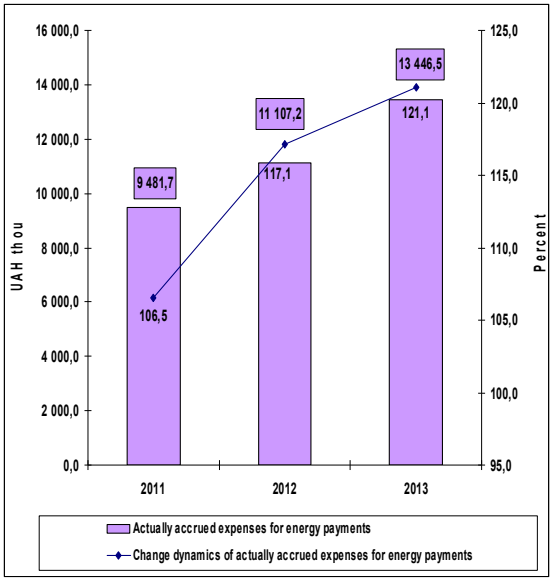
On the other hand, expenditures decreased in Kryvyi Rih and Kamyanets'-Podilskyi, which shows undertaking of some energy saving activities in these cities, since the heated area and number of persons served changed only slightly (see Chart 3 and Chart 4).

Chart 1

Rate of Growth of Utility and Energy Expenditures in Slavutych in 2011-2013

Chart 2

Rate of Growth of Utility and Energy Expenditures in Luhansk in 2011-2013



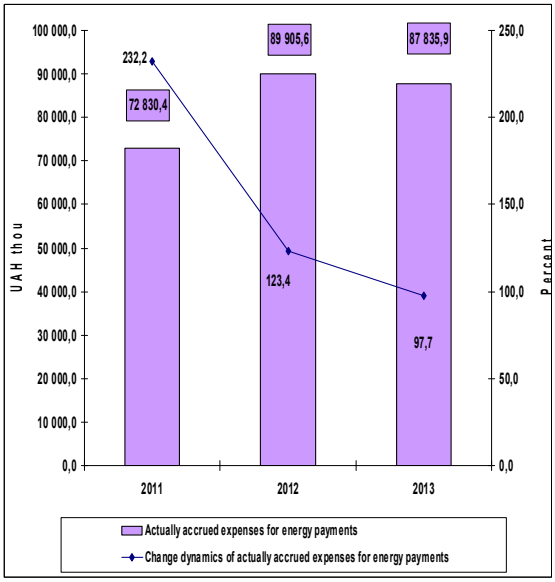


Chart 3

Rate of Growth of Utility and Energy Expenditures in Kamyanets'-Podilskyi in 2011-2013

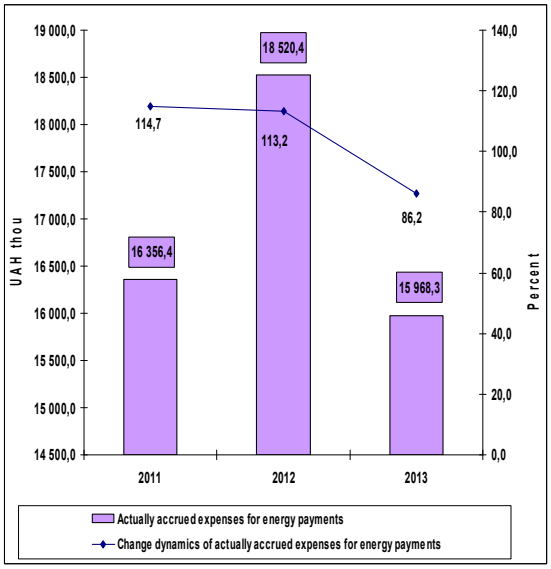
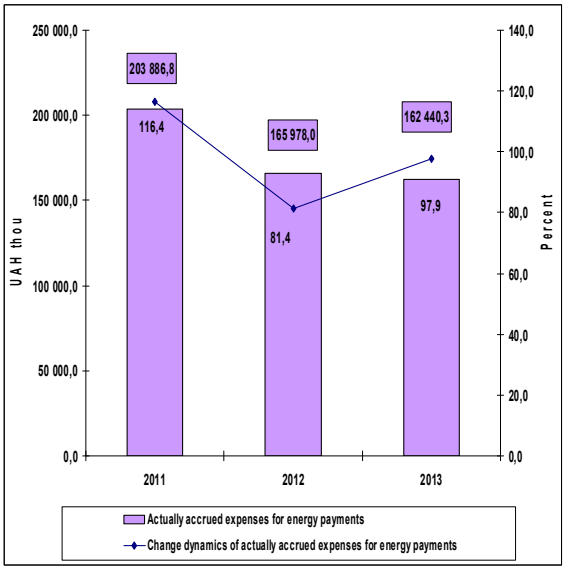


Chart 4

Rate of Growth of Utility and Energy Expenditures in Kryvyi Rih in 2011-2013

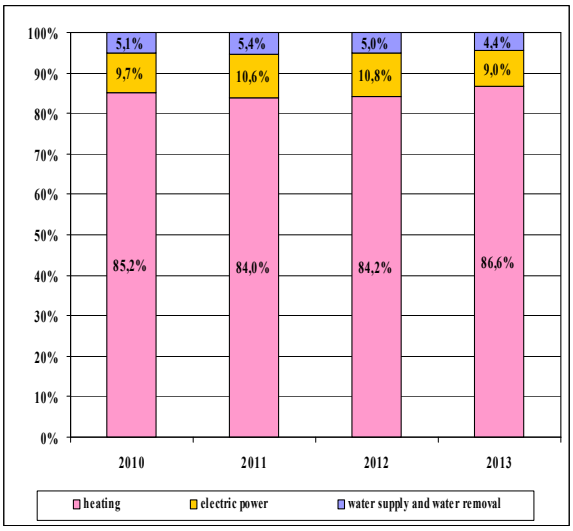


Heating has the largest proportion in the overall structure of energy expenditures of the four cities (83.1% on average for the cities in 2013). Electric power is the second largest group of expenditures, with an average percentage of 13.0% in the total structure of all selected cities in the last four years (see Chart 5).

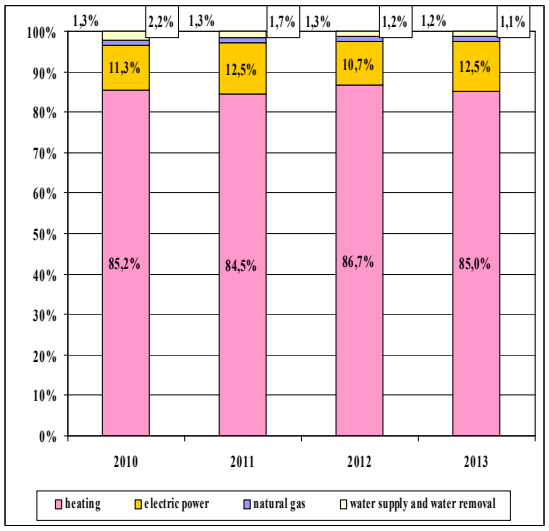
Chart 5

Structure of Energy Expenditures by Sector in 2010-2013

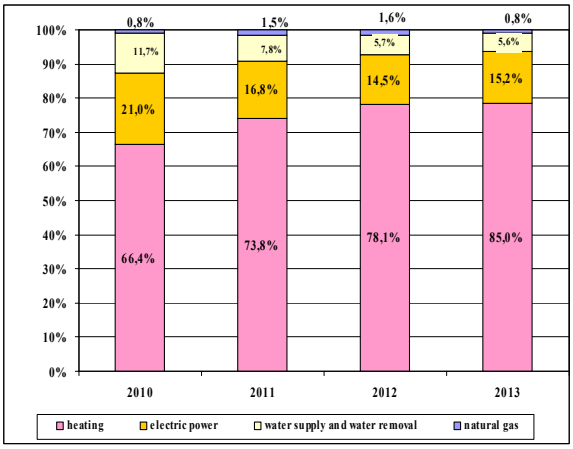
Slavutych Municipality



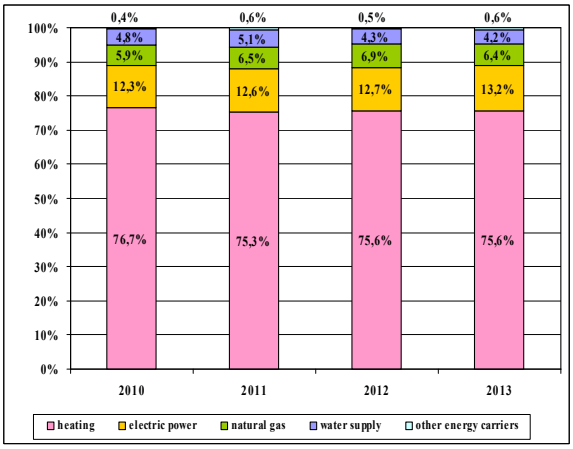
Kryvyi Rih Municipality



Luhansk Municipality

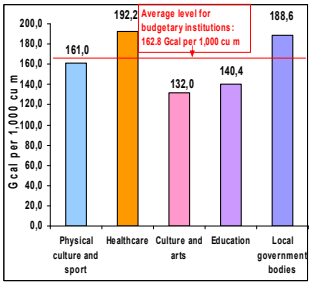


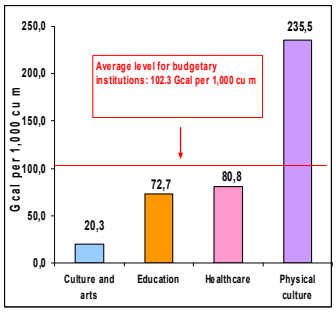
Kamyanets'-Podilskyi Municipality



Widely differing amounts of heat consumption per 1,000 cu m of heated space were observed in 2013:

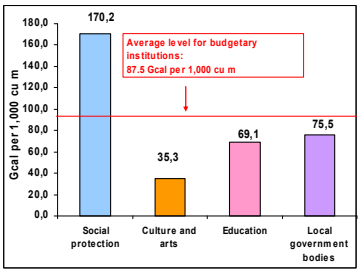
The highest amounts were used by budgetary institutions in **Luhansk** in 2013 (based on the average indicator value for all sectors, which amounted to 162.8Gcal per 1,000 cu m).

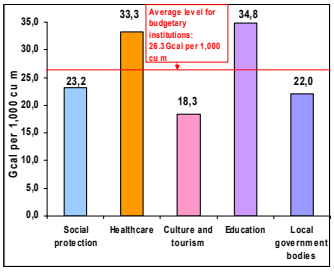




The average indicator for all budgetary institutions of **Kamyanets'-Podilskyi** amounted to 102.3Gcal per 1,000 cu m in 2013.

The **Slavutych** city showed the heat consumption level of 87.6Gcal per 1,000 cu m of heated space.



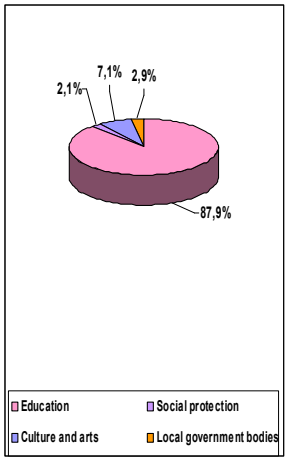


Kryvyi Rih shows the lowest heat consumption level with 26.3Gcal per 1,000 cu m of heated space.

Based on the conducted analysis of municipal budget expenditures for energy, the following was found:

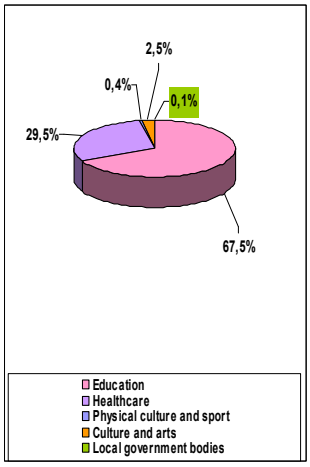
Chart 6

Structure of Heat Consumption by Slavutych Budgetary Institutions in 2013



The highest shares are noted for budgetary institutions in education (87.9% in 2013) or 0.4ppt more year-on-year, and culture and arts (7.1% or 0.3ppt more year-on-year). The share of consumption in the department of social protection varies from 2.2% in 2012 to 2.1% in 2013. The budgetary institutions of local government account for 2.9%.

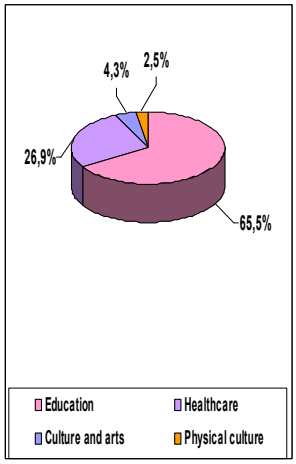
Structure of Heat Consumption by Luhansk Budgetary Institutions in 2013



The highest shares are recorded for budgetary institutions in education (67.5% in 2013), which remained at 2012 level, and healthcare (29.5% in 2013), which decreased by 0.3ppt against 2012, as well as culture and arts (2.5%, which is 0.3ppt more year-on-year).

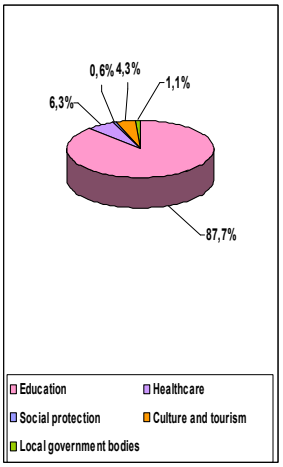
In the department of physical culture and sport and for local government bodies, the share of consumption remained unchanged in 2012-2013 at 0.4% and 0.1%, respectively.

Structure of Heat Consumption by Kamyanets'-Podilskyi Budgetary Institutions in 2013



The highest shares fall on educational budgetary institutions (65.5% in 2013, up 0.2ppt year-on-year) and healthcare institutions (26.9% or 1.6ppt less than in 2012). In 2013, the share of consumption in the department of culture and arts increased by 1.3ppt year-on-year and amounted to 4.3%. Budgetary institutions in the department of physical culture account for 2.5%.

Structure of Heat Consumption by Kryvyi Rih Budgetary Institutions in 2013



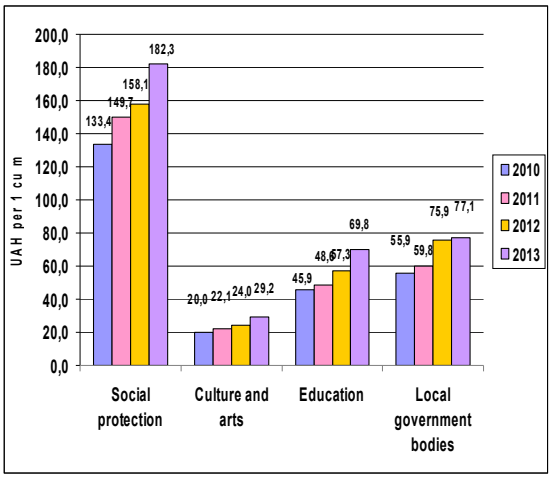
The highest shares fall on budgetary institutions of education (87.7% in 2013, up 0.5ppt year-on-year) and healthcare (6.3% in 2013, down 0.8ppt year-on-year), as well as culture and tourism (4.3%, which is 0.2ppt more than in 2012). In the department of social protection, the consumption share varies from 0.5% in 2012 to 0.6% in 2013. Budgetary institutions of local government account for 1.1%.

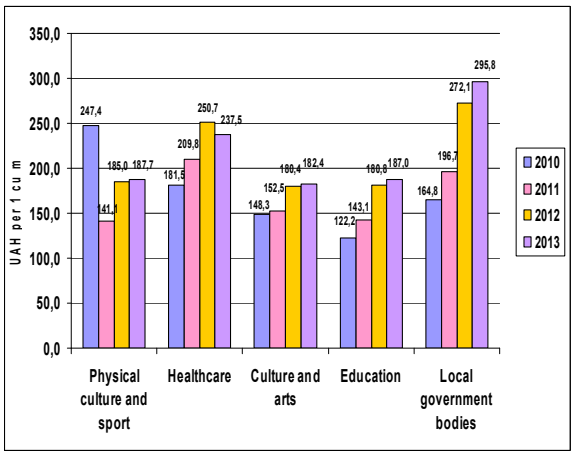
The amounts of funds spent by budgetary institutions for energy per 1 cu m of heated space differed significantly in the selected cities and were as follows in 2010-2013:

Slavutych

The largest amounts of such funds in 2013 were spend by social protection institutions, where they equaled UAH 182.3 per 1 cu m, with UAH 69.8 per 1 cu m for education, and UAH 77.1 per 1 cu m for local government bodies.

This indicator was the lowest for the budgetary institutions in the department of culture and arts at UAH 29.2 per 1 cu m in 2013.





Luhansk

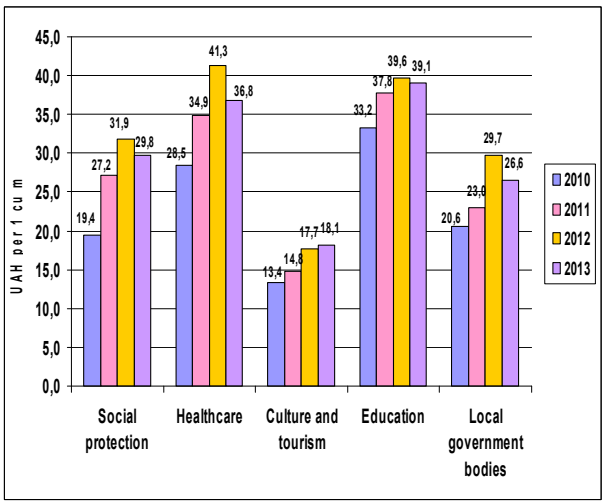
The largest amount of such funds was spent by the institutions of local government bodies, where it equaled UAH 295.8 per cu m in 2013, with UAH 237.5 per 1 cu m for healthcare department, UAH 187.7 per 1 cu m for physical culture and sports, and the same amount of UAH 187.0 per 1 cu m for education.

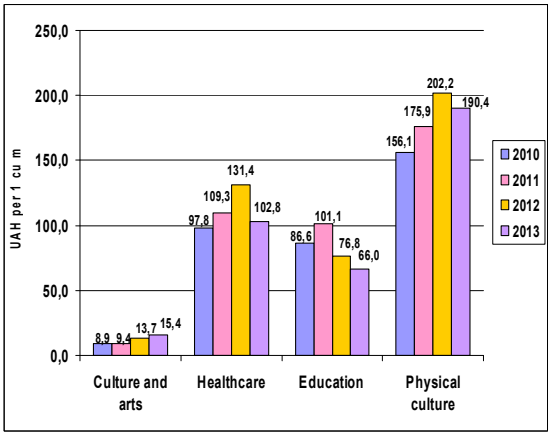
For the budgetary institutions in the culture and arts department, this indicator was the lowest at UAH 182.4 per 1 cu m in 2013.

Kryvyi Rih

The largest amount of such funds was spend by institutions in the education department, where it amounted to UAH 39.1 per 1 cu m in 2013, with UAH 36.8 per 1 cu m for healthcare, UAH 29.8 per 1 cu m for social protection, and 26.6 per 1 cu m for local government bodies.

This indicator was the lowest for the culture and tourism budgetary institutions at UAH 18.1 per 1 cu m.





Kamyanets'-Podilskyi

The largest amount of such funds was spent by physical culture institutions at UAH 190.4 per 1 cu m in 2013, followed by healthcare department at UAH 102.8 per 1 cu m, and education at UAH 66.0 per 1 cu m.

This indicator was the lowest for the budgetary institutions in the culture and arts department at UAH 15.4 per 1 cu m.

Based on the analysis findings, the MFSI-II experts have developed recommendations for the Project cities (Slavutych, Luhansk, Kryvyi Rih, and Kamyanets'-Podilskyi):

1. Track the energy performance and condition of buildings when finalizing the system of monitoring and evaluation of energy expenditures of each city.
2. It is advisable to investigate the reasons behind high levels of heat consumption per 1,000 cu m of heated space in some cities, and examine the factors, which have contributed to lowering these levels in others.
3. It is advisable to apply certain standards for ratios of heated space to the number of persons served by institutions (or to the number of staff for the institutions, which provide government services), which, in turn, would allow to analyze the efficiency of using the space occupied by budgetary institutions.
4. When improving the system of monitoring and evaluation, make sure to document the justification of the interrelation between the decrease / increase in consumption of utilities and energy and the energy saving activities, deterioration of the state of buildings, weather conditions etc.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

MFSI-II experts updated the system for monitoring energy-related budget expenditures for the selected cities. The new system has been brought in conformity with the latest changes in the Ukrainian budget legislation and in order to facilitate its using. Thanks to incorporation of the above-mentioned methodology and optimization of the calculation section, the MFSI-II experts have made this system more user-friendly for specialists of local councils and, at the same time, more effective for monitoring and evaluation.

The system is based on the principles of completeness, unification, and formalization of documents and periodicity. Thus, completeness of information will ensure that system for monitoring energy-related budget expenditures is used by all budgetary institutions within an individual city. Unification and formalization of the documents and indicators used for monitoring and evaluation will provide for equivalence and comparability of information. Strict periodicity of generating the information on energy consumption by budgetary.

The calculation was simplified of the actual heat energy consumption by an institution in the previous (or the baseline for results of implementation of energy performance projects) year adjusted for the reporting year ($Q_{прив}^{факт}$). It is proposed to calculate it from the following formula:

$$Q_{прив}^{факт} = Q^{факт} \cdot K_{прив}$$

where: $Q^{факт}$ is the actual consumption of heat energy (natural gas) for heating (based on readings of heat energy metering unit);

$K_{прив}$ is the reporting year adjustment factor found from the formula:

$$K_{прив} = \frac{ГД^{звітн}}{ГД^{факт}},$$

where: ГДзвітн is the average value of degree-days in the reporting heating period calculated based on the actual ambient temperatures in the respective months of the year;

ГДфакт is the value of average annual degree-days in the previous heating period (or the year preceding the year when the energy performance activities / project were implemented).

$$ГД = \sum_{j=1}^{7} (t_{вн} - t_{зовн\ j}) \cdot K_{діб\ j}$$

j is the month of the respective heating period;

$t_{вн}$ is the indoor temperature in the premises approved for respective buildings and structures based on their intended use;

$t_{зовн\ j}$ is the average ambient temperature for month j and the respective heating period (based on meteorological service data);

$K_{діб\ j}$ is the number of heating period days in month j of the respective heating period.

Also, the updated system describes in detail the formulas for calculating the indices and provides examples, which makes the system of monitoring and evaluation significantly more user-friendly. In the Excel attachment, calculations will be made automatically based on the underlying formulas.

I1 - Index of change in the volume of communal services and energy-carriers consumed under budget program

$I_1 = (I_{1a} + I_{1b} + I_{1c}) / 3$

I1 0,826936027 Moderate efficiency of budget expenditures

Item #	Indicator	2013	2014
1.	Total floor space (sq m)	100	120
2.	Heated space (cu m)	75	80
3.	Volume of heat energy consumption with temperature regime factor (cu m)	1000	1500
4.	Volume of electric energy consumption (kW per 1 sq m of total floor area)	500	550
5.	Volume of natural gas consumption with temperature regime factor (cu m)	140	220

Efficiency of budget expenditures	Score (proposed scale)
High	1 and more points
Moderate	0.7-0.9 points
Low	less than 0.7 points

I1a – Index of change in the volume of heat energy consumption

I1a 0,711111111 Moderate efficiency of budget expenditures

I1b – Index of change in the volume of electric energy consumption

I1b 1,090909091 High efficiency of budget expenditures

I1c – Index of change in the volume of natural gas consumption

I2 - index of changes in the cost of communal services and energy consumed under budget program

$I_2 = (I_{2a} + I_{2b} + I_{2c}) / 3$

I2 0,895632314 Moderate efficiency of budget expenditures

Item #	Indicators	2013	2014
1.	Expenditures per 1 sq m of total floor space	300	275
2.	Expenditures per 1 cu m of heated space	140	130

Efficiency of budget expenditures	Score (proposed scale)
High	1 and more points
Moderate	0.7-0.9 points
Low	below 0.7 points

I2a – Index of change in the cost of consumed heat energy

I2a 0,766811966 Moderate efficiency of budget expenditures

I2b – Index of change in the cost of consumer electric energy

I2b 1,190082645 High efficiency of budget expenditures

I2c – Index of change in the cost of consumed natural gas

I2c 0,731002331 Moderate efficiency of budget expenditures

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Based on an updated system of monitoring and evaluation of efficiency of budget expenditures for utilities and energy (based on the Performance Program Budgeting method), MFSI-II experts have updated the respective training materials.

On 19 September 2014, the Municipal Finance Strengthening Initiative (MFSI-II) Roll-out Project delivered a topical seminar on Financial Mechanisms for Improving Energy Efficiency in the Budgetary Sphere.

The Project gave the seminar to energy efficiency specialists from the cities of Kyiv, Slavutych, Kryvyi Rih, and Kamyanets'-Podilskyi. Content included an updated system of monitoring and evaluating the efficiency of energy expenditures and a mechanism for implementing a system of financial incentives for savings in energy resources.

There were 22 participants total, including 12 women and 10 men.

The specialists received recommendations regarding the principles and procedures for calculating the budget funds saved in payments for energy carriers and possible ways to account and use such funds.

Representatives from Slavutych, Kryvyi Rih, and Kamyanets'-Podilskyi shared their experience of implementing and operating energy monitoring schemes in their respective cities. The specialists took an active part in discussing the proposed system, and shared their own experience in the field of stimulating energy efficiency and energy conservation.

Based on the results of this event, proposals have been prepared and recommendations developed to enable cities improve the level of energy conservation in the budgetary sphere and promote a more transparent and efficient use of local budget resources.

See folder "Deliverables"

Task 2.2: Assist in designing and implementing financial incentives to promote the establishment of effective energy savings systems in the public sector

- IBSER experts will help municipalities design and introduce financial incentives to promote the establishment of effective energy savings system in the public sector.
- If needed, a review and improvement of the budget legislation needed for implementation of the said financial incentives will be carried out under Task 1.2.3.
- To help the chosen municipalities **introduce** the financial incentives that foster energy efficiency, IBSER will provide advisory support to the municipalities in designing budget programs, in particular, those intended for the realization of individual investment projects.

Updated Recommendation on financial incentives to promote the establishment of an effective energy savings system in the public sector have been presented on **5 April 2013** at the 11th Forum "Energy Efficiency of Budget Expenditures as a Road to Economic Prosperity". To facilitate practical application of the above-mentioned Recommendations, the MFSI-II experts provided consultations to the city of Zhytomyr with regard to the Procedure of using the funds saved in utilities and energy costs. The MFSI-II experts helped to prepare a draft Zhytomyr City Council resolution approving this Procedure.
Accomplished (see "Quarterly Report 01 March – 31 July, 2013").

Deliverable: Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are updated and presented at a session of the Financial and Economic Forum.
Timeline: October 2013 – March 2014

MFSI-II experts at the National Advisory Board (NAB), which held on December 24, 2013,

introduced suggestions on how to settle issues that arise when implementing loan-financed energy effective projects. The current situation carries certain risks of local debt repayment with the saved energy resources funds resulted from these projects. Meeting participants agreed that the issue was of high importance and it would be necessary for MFSI-II experts to develop a respective regulatory act.

Settling this issue will fulfill the terms and conditions of the loan for implementing energy effective projects, and improve solvency of local governments' energy budgets.

Accomplished (see "Quarterly Report 01 September – 31 December, 2013").

MFSI-II experts provided their proposals to the Ministry of Finance with regard to amending the Budget Code to regulate the issues of implementation of energy performance projects in the budgetary sphere of local budgets at the expense of attracted funds. Adoption of the said proposals will create significant financial incentives for local governments to reduce energy consumption in the public sector by implementation of energy performance projects at the expense of credit resources.

Due to postponement of the dates of the Financial and Economic Forum, the finalized recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector will be presented at this event at the time of its holding.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Updated Recommendation on financial incentives to promote the establishment of an effective energy savings system in the public sector will be presented at a session of the next Financial and Economic Forum.

Deliverable: Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are updated and presented at a session of the Financial and Economic Forum.

Timeline: October 2013 – September 2014

MFSI-II experts are providing systematic consultations to the Project cities on implementation of a system of financial stimulation for efficient use of energy resources by budgetary institutions, including the development of budget programs and individual investment projects. Also MFSI-II suggested to address certain additional issues for each local council.

Deliverable: Consultations on system implementation provided to the cities, including for development of budget programs and individual investment projects.

Timeline: October 2013 – September 2014

Task 2.3: Assist partner municipalities in building capacity of municipal enterprises to conduct modern financial analysis and planning to support their strategic and annual plans

The IBSER experts assisted the partner cities in strengthening the capacity of communal service enterprises to carry out a financial and economic analysis and planning as part of their strategic plans and action plans, including their coordination and matching with the municipality's strategic goals and objectives.

During the first and second years of project implementation, the MFSI-II experts have developed the training materials for conducting the monitoring and evaluation of the energy efficiency projects implemented by municipal enterprises.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

MFSI-II experts presented a methodology of monitoring and evaluation of energy performance projects and their recommendations for improving the effectiveness of financial justification of strategic documents by communal service enterprises at a seminar held on 29 March 2013. Based on the seminar results, the MFSI-II experts forwarded letters with the presentation materials to the participants to provide their comments and highlight issues.

Accomplished (see "Quarterly Report 01 January – 31 March, 2013")

Deliverable: Report prepared on the number of trainings on the monitoring and evaluation of energy efficiency projects implemented by municipal enterprises and implementing of the methodology of financial and economic justification of strategic and planning documents of municipal enterprises consistent with the municipality's strategic goals held and the number of specialists who participated in trainings with a breakdown by sex
Timeline: January – March 2014

On 31 March 2014, MFSI-II experts provided support in delivering a seminar Planning and Evaluation Efficiency, Including That for Energy Performance Projects, as the Guarantee of Achievement of Strategic Objectives.

The event was attended by representatives of the municipal utilities and executive committees of city councils from the Project cities, including Kyiv, Lutsk, Alchevsk, Ternopil, Myrhorod, and Vinnytsya (total of 27 participants, including 14 women and 13 men).

In the course of the seminar, the MFSI-II experts presented to the participants their proposals for improving the effectiveness of financial justification of strategic documents by municipal utilities in the context of city development priorities, and familiarized the participants with the methodology of monitoring and evaluation of energy performance projects.

Also, the representatives of Kyiv, Myrhorod, and Vinnytsya presented the experience of their municipal utilities in monitoring the energy consumption in their municipalities, mobilizing financial resources, and implementation of energy performance projects.

The knowledge and skills acquired at the seminar will make it possible to introduce into everyday activities of the municipal utilities the methodological recommendations for effective strategic planning and evaluation of energy performance projects, and help systematize the directions for implementing energy saving activities.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Deliverable: Consultations to the staff of municipal enterprises on using the methodology provided
Timeline: October 2013 – September 2014

The communal service enterprises of the Project cities are receiving ongoing assistance and online consultations from MFSI-II experts on the monitoring and evaluation methodology of energy performance projects and recommendations for improving the effectiveness of financial justification of strategic documents.

The MFSI-II Project experts provided recommendations for improving strategic planning in the context of city development priorities and a more realistic financial justification to the city of Lviv Comprehensive Development Strategy for the years 2012-2025, Lviv Heating Facilities Reconstruction

and Modernization Program, Lviv Sustainable Energy Development Plan until the year 2020, and the Lvivteploenergo Lviv Municipal Heating Utility Strategic Development Program until the year 2016.

As part of the analysis, conclusions were made about the interrelations between the Lviv City Development Strategy for 2012-2025 and the Lvivteploenergo Heating Utility Strategic Development Plan until the year 2016, which contains Lvivteploenergo's priority investment projects for the period of 2013-2016.

In particular, the following recommendations were provided:

1. The Lvivteploenergo's Heating Utility strategic development program must reflect the criteria of implementation of City's Strategy at the date of its completion, i.e., at the end of 2016. At the same time, it is the City Strategy, which is the primary document, therefore, it needs to contain the tasks and their specific performance indicators also for the Lvivteploenergo utility.
2. The City Development Strategy must also include a financial strategy, with an allocation of sources of financing by type and year. Also, the financial strategy must provide for the mechanisms of attracting investments, including foreign investments, for modernization and technological upgrade of the housing and communal services sector.
3. As regards the works planned under the Lvivteploenergo Strategic Development Program, the following performance indicators will need to be defined:
    - reduction of emissions of hazardous substances and greenhouse emissions in the atmosphere (by type);
    - reduced use of energy for operational needs (by type);
    - reduced heat losses in transit to the end user.

<u>Accomplished</u> (see “Quarterly Report 01 January 2014 - 31 March 2014”)

The MFSI-II Project experts provided recommendations for improving strategic planning in the context of city development priorities and a more realistic financial justification to the city of Pavlohrad Comprehensive Development.

Recommendations provided to the management of the Pavlohrad City Municipal Enterprise Pavlohradsky VUVKH on improving the efficiency of financial justification of the Enterprise Strategic Development Program in the 2010-2014.

<u>Accomplished</u> (see “Quarterly Report 01 April 2014 - 30 June 2014”)

The MFSI-II Project experts provided recommendations for improving strategic planning in the context of city development priorities and a more realistic financial justification to the city of Lviv Comprehensive Development.

Recommendations for the management of the Lviv City Municipal Lvivteploenergo Heating Utility with regard to improving effectiveness of the financial justification of the Enterprise Strategic Development Program until the year 2016 in the context of the city development priorities established by the Comprehensive Lviv Development Strategy for 2012-2025, Program for Reconstruction and Modernization of the City of Lviv Heating and Energy System (Resolution No.1239 of the Lviv City Council dated 29 April 2004), and the Lviv Sustainable Energy Development Plant until the year 2020.

See folder “Deliverables”

Objective C: Enhance public awareness of the public budgeting process, revenues and expenditures

Task 3.1: Analyze the execution of budgets at all levels and analyze the budget legislation, disseminate impartial information

IBSER will prepare an independent budget implementation and budget legislation analysis to support the efficient and transparent implementation of local budgets. Thus, work will continue to analyze the execution of budgets at all levels and analyze budget legislation. In particular, in order to ensure the monitoring of the impact of the changes to the local revenues legislation, the IBSER will conduct a constant monitoring of the budget process in all of its stages. The results of the monitoring will be presented in monthly and quarterly publications dedicated to the analysis of the budget execution. The results of the monitoring and analysis conducted will be disseminated among all the stakeholders and partners.

Result: IBSER experts will prepare a monthly monitoring of national and local budget implementations and place it on the IBSER's Web-site (web-page).
Deliverable: Monthly monitoring
Timeline: The monthly monitoring in electronic form is prepared and placed on the IBSER's Web-site (web-page) by the end of second week of every month

In the reporting timeframe, the project prepared monthly monitoring reports (three for the reported period) on the implementation of the state and local budgets for the period from May 2014 to July 2014 (See "PMP"). The reports were placed on the website. On the whole, there were 33 monthly monitoring reports prepared and published on the website since the launch of MFSI-II.

See folder "Deliverables"

Result: Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process
Deliverable: Budget Monitoring
Timeline:
The Monitoring for Quarter 3, 2013 is placed on the IBSER's Web-page by December 31, 2013.
The Monitoring for Quarter 4, 2013 is published, distributed among the IBSER's partners, and placed on the IBSER's Web-page by March 31, 2014.
The Monitoring for Quarter 1, 2014 is placed on the IBSER's Web-page by June 30, 2014.
The Monitoring for Quarter 2, 2014 is published, distributed among the IBSER partners, and placed on the IBSER's Web-page by September 30, 2014.
Result/ Deliverable:

In total, there were ten quarterly monitoring reports prepared and published on the website since the beginning of the MFSI-II Project.

According to the State Treasury preliminary data, MFSI Project experts prepared the *Budget Monitoring for January–June 2014* (See "PMP").
The monitoring included an analysis of the latest trends regarding the State and local budget

execution, as well as an analysis of the legislative acts influencing the budget process, approved over the reporting period. *The Budget Monitoring* was distributed among the interested parties and stakeholders, and placed on the website. Key highlights include:

The macroeconomic situation remained unfavorable in Q2 2014. The real GDP was 4.7% down year-on-year (in comparable 2007 prices)[1] against its 1.3% decline last year. By comparing the 2014 and 2013 Q2 indicators in the Eurozone and the EU countries, it can be seen that they show a 0.7% and 1.2% real GDP growth, respectively[2].

The nominal GDP totaled UAH 685.8bn, which is UAH 32.3bn or 4.9% more year-on-year. This amounts to a mere 44.2% of the nominal GDP figure used for drawing up the 2014 State budget[3].

Industrial output grew after its downslide by 0.5ppt in the first quarter of this year. For instance, the industrial production index amounted to 95.3%[4] vs. 95.0% in the respective period of 2013.

At the same time, this indicator dropped by 3.9% for agriculture.

The Consumer Price Index increased to 111.6% from 100.2% in the respective period of 2013. Prices of nearly all goods and services increased in the period under review

The foreign trade balance of Ukraine was a positive one of $3.7bn compared to a negative balance of -$0.7bn in the respective period of last year.

The nominal average monthly wage per one full-time employee amounted to UAH 3,601.0 in Q2 2014, up 6.5% year-on-year.

The real wage decreased by 0.4% in Q2 (up 9.6% in the respective period of 2013).

The actual intake of revenues of the consolidated and State budget demonstrated some year-on-year growth. Thus, according to official statistics, the actual intake of revenues of the consolidated budget of Ukraine totaled UAH 224.5bn, which is UAH 13.4bn or 6.4% more year-on-year and amounted to 45.6% of the plan. The actual intake of revenues of the State budget of Ukraine totaled UAH 175.9bn, which is UAH 13.3bn or 8.2% more year-on-year.

Nearly 2.2 times higher non-tax revenues were the key driver behind increased budget revenues. On the other hand, the key tax items demonstrated lower amounts year-on-year. Drop in revenues from the enterprise profit tax amounted to 18.2%, excise tax on goods made in Ukraine - 11.9%, and import duty - 13.3%. The amount of the value-added tax was slightly higher than last year (+UAH 2.6bn or +4.2%); however, this occurred thanks to reducing the tax budget refunds by UAH 7.1bn or by 26.0% rather than as the result of increased net tax receipts.

Structure of Revenues of the Consolidated and State Budgets of Ukraine in January–June 2012–2014

(%)

Revenues	Consolidated budget			State budget		
	2012	2013	2014	2012	2013	2014
Tax revenues, including:	**84.4**	**82.5**	**77.5**	**84.0**	**81.1**	**75.3**
– enterprise profit tax	13.7	14.6	11.1	17.6	18.8	14.2
– value-added tax	32.4	29.1	28.5	41.7	37.9	36.6
– excise tax	8.8	8.7	8.6	11.0	11.1	10.9
– taxes on foreign trade and external transactions	3.0	2.9	2.4	3.8	3.8	3.1
Non-tax revenues	**14.9**	**16.8**	**21.9**	**15.7**	**18.5**	**24.3**
Income from capital transactions	**0.5**	**0.3**	**0.3**	**0.1**	**0.0**	**0.1**
Targeted fund	**0.1**	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**
Other revenues	**0.1**	**0.2**	**0.2**	**0.1**	**0.3**	**0.2**

A high level of execution for non-tax revenues is provided, in particular, thanks to the funds remitted to the State budget by the National Bank of Ukraine at UAH 22bn, which amounts to nearly 96.5% of the annual plan for this item.

The local budget revenues (without inter-budget transfers) totaled UAH 49.7bn, which is 0.9% more than in January-June 2013. The level of execution of the revenue plan approved by local councils amounted to 45.4%.

The amount of tax revenues, which make up 85.1% of local budget revenues (without inter-budget

[1] http://www.ukrstat.gov.ua/
[2] http://ec.europa.eu/eurostat
[3] According to an updated realistic forecast of macroeconomic indicators, which is the closest to the International Monetary Fund estimates.
[4] Without the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.

transfers), totals UAH 42.2bn, which is 1.6% less year-on-year. The decline in the amount was due to reduced proceeds from the main sources of revenue generation of local budgets, i.e., the personal income tax and payment for land, which demonstrated a decline by 0.2% year-on-year, each.

The highest growth rate among the sources of revenues of local budgets is demonstrated by the single tax on small businesses received at the amount of UAH 3.5bn, which is 13.1% greater than in January-June 2013. Inclusion of the single tax into the development budget has had a positive effect on the status of revenues of this budget (said revenues amounted to 73.6% of all development budget revenues).

The level of execution of **consolidated budget expenditures** decreased by 2.0ppt against January-June 2013 and amounted to 42.5%.

The growth rate of consolidated budget expenditures slowed down by 8.1ppt and amounted to 102.1%. The share of consolidated budget expenditures in GDP decreased to 35.6% or by 0.9ppt, given that the GDP grew by 4.6ppt year-on-year.

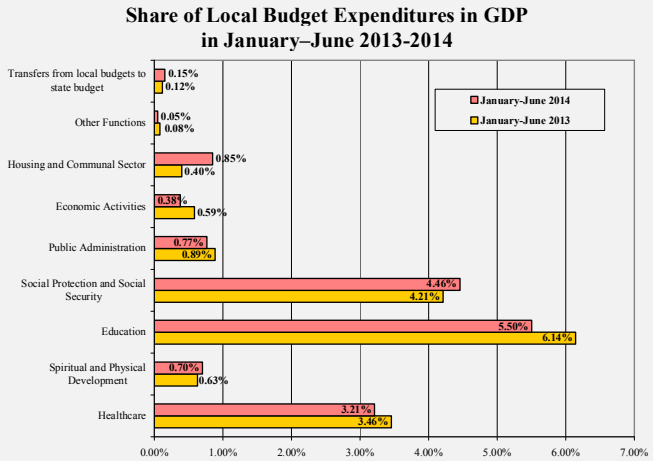
The share of local budget expenditures in the consolidated budget expenditures decreased by 0.3ppt year-on-year and amounted to 44.7%.

The State budget expenditures totaled UAH 197.6bn, which amounts to 43.8% of the annual target (the annual plan was executed by 43.7% in the first six months of 2013). Those best-funded were the expenditures for social protection and social security (49.4% of the annual plan, which is 0.2ppt less year-on-year), inter-budget transfers (48.8%), spiritual and physical development (44.4%), and education (44.3%). The lowest funding levels are recorded for expenditures for environmental protection. The amount spent for this purpose amounted to UAH 954.9mn in the first half of this year or 14.3% of the annual plan.

The main priorities of the State policy in the context of increasing expenditures of the State budget compared to last year (71.4% of the total increase amount) included expenditures for inter-budget transfers (they accounted for 46.3% of all increase in expenditures); debt servicing - 33.1%; and military defense - 8.8%.

The local budget expenditures (with inter-budget transfers) only increased by 1.8% and totaled UAH 110.2bn. The level of execution of the annual plan approved by local councils amounted to 43.3%. As usual, the majority of local budget expenditures are used in the social and cultural sectors.

Growth was noted in the first half of 2014 in expenditures for culture and arts (+28.6%), inter-budget transfers (+35.7%), and housing and communal services (+122.1%). The latter's growth was influenced by granting a State budget subvention to local budgets in the first half of the year to repay arrears in the difference in tariffs totaling UAH 3.8bn, where expenditures for that subvention only amounted to UAH 0.1bn in the respective period of 2013.



The share of expenditures for payroll with taxes is commonly the largest item from among all local budget expenditures. It decreased by 3.8ppt compared to last year and amounted to 45.1%. Also, the amounts of said expenditures decreased by UAH 3.2bn or by 6.1% and amounted to UAH 49.7bn. On the whole, the current expenditures of local budgets totaled over UAH 106.0bn, which is 3.6% more than in January-June 2013. Capital expenditures were funded at UAH 4.2bn, and their amount decreased by UAH 1.8bn or by 29.6%.

The State budget deficit totaled UAH 22.7bn, which equals 33.2% of the ceiling set by the Law on the State Budget of Ukraine for the Year 2014. This deficit amount is the same as the relevant indicator in January-June 2013.

The State budget borrowing totaled UAH 110.2bn (55.3% of the annual plan), including internal

borrowing of UAH 55.6bn or 51.0% of the annual plan, and external borrowing of UAH 54.6bn or 60.5%. **State debt repayment** totaled UAH 48.0bn, which amounts to 44.0% of the annual plan, including internal debt repayment of UAH 31.5bn or 46.5% of the annual plan, and external debt repayment of UAH 16.5bn or 39.8%. A widening was observed between the borrowing and repayment amounts compared to the respective period of last year, which will lead to increased debt burden on the budget in future, however is essential in the present Ukrainian situation.

According to the State Treasury Service, **the amounts of loans for covering temporary cash gaps of local budgets** against resources of the Single Treasury Account totaled UAH 18.1bn, which is 34.5% less year-on-year.

The proceeds from privatization of State property were received at the amount of UAH 0.05bn or 0.3% of the annual plan. Such proceeds totaled UAH 0.03bn or 0.2% of the annual plan in January-March 2013.

The balance of budget funds at the end of March 2014 totaled UAH 47.9bn, having grown by UAH 17.1bn or 1.6 times year-to-date. To compare, the balance increased by UAH 10.8bn or 1.4 times year-to-date in January-June 2013.

See folder "Deliverables"

Task 3.2: Conducting public events and engaging the public in the budget process

In order to efficiently engage the public in the budget process and sound the public opinion, IBSER will support the holding of public hearings. IBSER will continue its practices of holding meetings of the National Advisory Board and the Financial and Economic Forums on an ongoing basis with an invitation extended to all interested parties, including to representatives of the general public. In order to ensure the broadest possible dissemination of information at the local level and raising the level of public awareness, use will be made of all available mass media and other formats, such as holding of public hearings, publication of printed materials etc.

Result/Deliverable:
Participation of IBSER experts in working meetings, roundtables, conferences, including international ones, radio and TV talk shows with the aim of disseminating information on the issues addressed by the project
Timeline: Ongoing process

On 15 October 2013 the MFSI-II Project took part in a roundtable discussion called, *Improving the Regulatory Framework for the Introduction of the Mechanism of Energy Service Contracts in Budgetary Institutions*. The roundtable was held as part of the implementation of the National Action Plan for 2013.

The meeting focused on the regulatory reform needed to improve the legislative environment for attracting investments in the energy efficiency sector, in particular, attracting investments for improving the energy efficiency of public buildings in Ukraine.

The participants considered two relevant legislative drafts registered with the Verkhovna Rada of Ukraine.

These drafts are designed to remove existing barriers to the introduction of energy service contracts in the budgetary sphere. The drafts contain Project proposals intended to shape the regulation of attracting private capital for implementing energy saving activities in budgetary institutions.

As we have already stated in previous reports, in the opinion of the Project, the legislative draft developed under the leadership of the National Commission for State Regulation of Public Utilities (National Commission) is more mature, contains less risks, and is based on systemic approach. Among

other things, it provides maximum protection to:

1) energy service companies by the statutory inclusion of the expenditures required to pay for the services of such companies under energy service contracts into local budgets;

2) cities from the failure of energy service companies to meet contracts and obligations, as payment for work will only be made based on actual savings.

Wrapping up the meeting, Minister Temnyk of the Ministry of Regional Development and Housing and Communal Services emphasized the need for coordinating the two legislative drafts submitted to the Verkhovna Rada and combining them into a single document. To this end, it is planned to set up tightly defined working groups.

On the whole, the approval of the amendments to the legislation will make it possible to:

- Introduce a transparent and coherent scheme of concluding and implementing energy service contracts;
- Increase the attractiveness of budgetary institutions for potential investors in the energy performance sector by guaranteeing the protection of their rights;
- Reduce the energy dependence of Ukrainian municipalities.

According to the Work Plan and striving to achieve the MFSI-II Project objectives, the Project experts are working together with other projects to submit legislative proposals, address the issues of energy efficiency at the local level and resolve other issues.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

As part of this collaboration and upon invitation of the Association of Ukrainian Cities (which is implementing the Dialogue Project), MFSI-II Project experts took part in a meeting of financial officers of Ukrainian cities. The event was held **on 31 October through 1 November 2013**, in the city of Zhytomyr, which has been participating in the MFSI-II Project since 2012.

The trip was intended to strengthen contacts with other stakeholders in order to finalize the legislative changes for implementation of energy service contracts in the budgetary sector.

The meeting participants emphasized an urgent need of attracting private investors in implementation of energy performance projects in buildings of budgetary institutions and adopting the relevant amendments to the legislation. At the same time, certain reservations were voiced with regard to one of the legislative drafts, which proposes to introduce exclusions in the general approach to the budget process. This, however, would disrupt the integrity of the whole this process.

For their part, the MFSI-II Project experts have already contributed their efforts to the formation of a systemic approach to implementation of energy service contracts in the budgetary sector. This approach is reflected in the legislative draft developed by the National Commission for State Regulation in the Public Utilities Sector.

The MFSI-II Project experts will continue taking part in further elaboration of the said legislative amendments, in particular, by joining forces with experts of the Dialogue Project.

The MFSI-II Project has been invited to join in the work of developing proposals for improving the Action Plan for implementation of the Public Finance Management Strategy of Ukraine approved by ordinance of the Cabinet of Ministers of Ukraine.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

This work was conducted **on 18 through 22 November 2013** at the Ministry of Finance of Ukraine as part of the consultations between experts of the Ministry of Finance, other agencies, and representatives of the donor community.

The MFSI-II Project experts provided their proposals on the issues of Performance Program Budgeting at the levels of the State and local budgets, medium-term budget planning, improving transparency of the budget process, and other issues relevant for the process of developing the public

finance management system of Ukraine.

The proposals contributed by the experts will be incorporated in an updated version of the Action Plan for implementation of the Public Finance Management System Development Strategy.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

On 22 November 2013, MFSI-II experts participated in a teleconference, which took place at EBRD with participants from Russia and the United Kingdom. The Ukrainian side was also represented at the teleconference by USAID and USAID's Municipal Energy Reform Project in Ukraine (MERP). Discussed at the meeting were the ways of improving the legislative amendments with regard to the legal foundations for operation of energy service companies and implementation of energy service contracts.

As is known, there are two legislative drafts on this issue: one developed with support from EBRD, and another with support from the National Public Utilities Regulatory Commission (the "National Commission"). Even though MFSI-II experts participated in developing both bills, the latter incorporates all the proposals made by the MFSI-II experts. We believe this draft is more mature, contains less risks, and is based on systemic foundations, while the EBRD legislative draft will need further elaboration.

Following the discussion, the participants decided to join efforts in developing the updated changes to the budget legislation and procurement legislation. The well-founded, finalized amendments to the budget legislation will be submitted to the Ministry of Finance of Ukraine.

The EBRD representatives from the United Kingdom have outlined the main directions of work in this area: 1) prepare a short document with key principles of energy service contracts; 2) develop a mechanism for implementation of such contracts; and 3) draft the agreed amendments to the Budget Code.

The abovementioned amendments should:

- not affect the deficit of budgets and amounts of the State and local debts;
- ensure the legitimacy of conclusion of contracts by budgetary institutions for a long-term period;
- envisage payments under energy service contracts only within the amounts of saved funds.

Adoption of the finalized amendments to the Budget Code will ensure:

- transparency of arrangements for concluding and implementing energy service contracts;
- attractiveness of the budgetary sphere for potential investors in the energy performance sector by means of guaranteeing the protection of their rights;
- reducing the energy dependence of Ukrainian cities.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

Experts of the MFSI-II Project took part in an off-site meeting of the Kyiv City Council held at the Pechersky District State Administration building on **4 February 2014**. The Council members to approve the Kyiv Program of Economic and Social Development and used a simplified procedure to approve 2014 city budget, which were approved with the revenues of UAH 20.1bn and expenditures of UAH 19.8bn. The end-of-year debt ceiling was set at UAH 10.0bn.

The 2014 budget includes UAH 30mn for the continued reconstruction of sludge bank dams at the Bortnychi aeration station, intended to prevent flooding and environmental damage. The Program allocates an additional UAH 70mn for the construction and repair of sewers and water supply networks.

Also in the housing and communal services sector, UAH 30mn is budgeted for the modernization, replacement, and reconstruction of residential elevators. An additional UAH 47mn is reserved for the construction of the Podilskyi bridge crossing over the Dnipro River.

Capital investments in 2014 will total UAH 1bn. Of those, UAH 944.8mn is allocated for the development budget, UAH 25mn for the environmental protection fund, UAH 21.7mn for the State budget grant for socioeconomic development activities, and UAH 12mn for building an access road and external infrastructure for the Bionic Hill innovation park.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

On **4 March 2014**, a representative of the MFSI-II Project took part in a meeting of financial officers of Ukrainian cities organized by the Association of Ukrainian Cities as part of USAID's Development Initiative for Advocating Local Governance in Ukraine (DIALOGUE) Project.

The participants discussed at the meeting the need for amending the Budget Code of Ukraine. Such amendments are intended to improve the transparency of the budget process, strengthen the financial sustainability of local budgets, and redistribute the powers in the financing of individual departments.

Also, the meeting participants discussed such matters as Government's intention to decentralize governance and devolve the powers and financial resources to local authorities. They have considered possible areas of local government reform, opportunities for cooperation between local governments and the Verkhovna Rada Committee on Budget, and the prospects for budget provision of local governments in 2014.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

On **26 March 2014**, experts of the MFSI-II Project took part in a meeting organized by the USAID Public-Private Partnership Development Project (P3DP) with participation of an UK consultant. The meeting focused on the ways of removing the barriers to implementation of Public Private Partnership formats, which require budgetary support.

Based on the discussion results, the meeting participants have agreed that commitments of the State under PPP agreements in the form of budgetary support should be similar to those of debt obligations. However, taking into account the special features of valuation of such commitments and lack of experience in this matter in Ukraine, the international expert will provide information on the practices of such valuation in England.

After studying the said information, the MFSI-II Project experts will work together with experts of the P3DP Project in preparing the amendments to the budget legislation, which would allow using the PPP formats for the implementation of infrastructure development projects.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

The MFSI-II Project took part in a roundtable meeting on the topic Prospects of the Country's Economic Reintegration: Powers, Resources, Responsibilities. The event was conducted by the National Institute for Strategic Studies on **23 April 2014**.

The meeting was attended by State government officials, leading scholars, representatives of local governments, and non-governmental organizations.

The attendees had a lively discussion regarding present-day regional policy and its further development. The Project made proposals for optimizing budget financial flows to ensure both economic efficiency and social fairness when distributing budget funds.

The meeting participants came to a common opinion that a new model of relations between the State and the regions would need to be based on increased interest of the regions in their own development, assuring equal relations between the State and the regions, as well as the achievement of the territorial consolidation of the country based on joint development and joint responsibility.

The proposals provided at the roundtable will be taken into account in a resolution to be prepared to document the meeting results.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 23 April 2014, upon an invitation from the Ministry of Regional Development, Construction, and Housing and Communal Services (Minregion), the MFSI-II Project took part in a meeting to discuss

further legislative regulation for implementing ESCO mechanisms in Ukraine.

Currently, there are two legislative drafts on the issue: one legislative draft developed with support from the EBRD; and one legislative draft supported by the National Communal Services Regulatory Commission (National Commission). Even though the Project took part in developing both drafts, the latter one takes into account all of the Project's proposals.

The meeting participants agreed that to provide an opportunity for implementing ESCO mechanisms, the Budget Code amendments developed by the National Commission need to be supported. Based on the meeting results, three working groups were set up to elaborate changes to various legislative acts on the matter. The Project leads a working group on finalizing changes to the Budget Code as agreed with EBRD. The well-founded, finalized changes will be brought for consideration of the Ministry of Finance and presented to the Cabinet of Ministers of Ukraine.

Adopting the changes to the main budget law drafted with the Project's participation will make it possible for the first time ever to settle the problem issues at the legislative level that stand in the way of implementing energy performance contracts. This will give a boost to the further reduction of Ukrainian cities' energy dependence.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 24 April 2014 the MFSI-II Project took part in a meeting hosted by the Ministry of Finance of Ukraine of the donor working group on public finance management.

During the meeting, the participants discussed the main areas of donor support and results of individual projects' activities in implementing public sector reforms. Also, V.P.Kolosova, deputy director of the Department for Debt and International Financial Policy, spoke highly of the active cooperation with the MFSI-II Project in this area. The group members have laid down further ways of implementing reforms, including improvements to the Performance Program Budgeting method at both the national and local levels.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 28 April 2014, the Ministry of Regional Development, Construction, and Housing and Communal Services (MinRegion) invited the MFSI-II Project experts to take part in a meeting for considering the issues of legislative regulation for implementation of ESCO mechanisms in Ukraine.

This meeting was held as part of continuation of joint activities by the MinRegion, National Communal Services Regulatory Commission (National Commission), MFSI-II Project, EBRD, and other stakeholders, which was launched at the initial meeting held on 23 April 2014.

As reported earlier, the MFSI-II Project leads a team for finalizing the amendments to the Budget Code agreed with EBRD experts. Presented at the meeting were the said amendments elaborated by experts of the MFSI-II Project with the National Commission and EBRD. After completion of work of finalizing other legislative drafts, which are an integral part of a package of documents related to legislative changes in order to regulate the introduction of ESCO mechanisms, they all will be presented to the Cabinet of Ministers of Ukraine.

Adoption of the changes to the main budget law, elaborated with participation of the MFSI-II Project experts, will make it possible for the first time to settle the problem issues, which stand in the way of introducing energy performance contracts at the legislative level. This will give a boost to further alleviating the energy dependence of Ukrainian cities.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 13 May 2014, the MFSI-II Project took part in a seminar titled Planning and Formation of a Realistic and Transparent Budget organized under the Public Finance Management Reform Support Project supported by the German Society for International Cooperation (GIZ).

The event was also attended by representatives of Ukraine's Ministry of Finance, Accounting Chamber, Secretariat of the Verkhovna Rada Committee on the Budget, leading scholars, and representatives of non-governmental organizations.

The attendees heard presentations by German expert Dr. Elke Baumann (Deputy Head of Public Finance Department, General Directorate of Fiscal Policy and Economic Relations at the German Federal Ministry of Finance). Dr. Baumann described the approaches used by EU Member-States in the course of budget planning, principles of macroeconomic forecasting of key budget indicators, and gave attendees an opportunity to study the practical aspects of German budget formation. Special focus was made on the issues of public engagement in the budget process and the requirements developed for EU Member-States regarding budget transparency.

The issues covered are highly relevant to the organizations that attended and will have to be taken into account when implementing the reform of the Ukrainian budget system.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 21 May 2014, the MFSI-II Project took part in a seminar on the Management by Objectives: The Performance Program Budgeting and Interbudgetary Relations, Decentralization delivered as part of the Support to Public Finance Management Reform Project sponsored by the German Society for International Cooperation (GIZ).

The event was also attended by the Ministry of Finance of Ukraine, Accounting Chamber, Secretariat of the Verkhovna Rada Committee on Budget, leading scholars and representatives of nongovernmental organizations.

The attendees heard presentations made by German experts Patrick Kraulich (head of the Strategic Planning Department at the Ministry of Finance of the Federal State of Hessen) and Guenter Weiland (head of the Supervision Department, Hessen Prime Minister's Office).

The German experts familiarized the seminar participants with their experience of applying the Performance Program Budgeting method for the formation and execution of budgets in the Federal State of Hessen, as well as with special features of building interbudgetary relations in an environment of budget decentralization.

The covered issues are extremely relevant and can be used for implementing the reform of the Ukrainian budget system.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On 22 May 2014, the Municipal Finance Strengthening Initiative Roll-out (MFSI-II) Project took part in a seminar on the topic of Modern Accounting Chamber: The UK Experience sponsored by GIZ Ukraine.

Participants included representatives of Ukraine's Accounting Chamber, secretariats of Verkhovna Rada committees, academics, and the international expert community.

The seminar was led by British experts David Galsworthy and Ian Rogers of the United Kingdom's Accounting Chamber. The seminar discussions focused on the issues of the role of a modern Accounting Chamber in the budget process in the light of UK experience and according to European standards.

Based on the seminar, recommendations have been elaborated for improving Ukraine's legislative framework, including the Law of Ukraine "On the Accounting Chamber of Ukraine". Implementing such recommendations will contribute to greater transparency in using State budget resources and ensure better public finance management.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Institute's experts took part in the 22nd Annual Conference Government vs. Governance in Central and Eastern Europe held in Budapest, Hungary, from **on May 22 through May 24, 2014**. The event was organized by the Network of Institutes and Schools of Public Administration in Central and Eastern Europe (NISPAcee) in collaboration with the Corvinus University and the National University of Public Service of Hungary. IBSER joined NISPAcee as early as 2007, and our experts are annually sharing their experience in the area of improvements of public administration, in particular, in the area of public finance.

This year's NISPAcee Conference was focused on the issues of development of the budget and fiscal policies in the countries of Central and Eastern Europe and Central Asia. The Conference agenda comprised a number of plenary sessions, working meetings on the key topic of the Conference, expert panel sessions, forums, and task forces arranged by topic and concentrated on specific matters of public administration.

22nd Annual NISPAcee Conference, 22-24 May 2014

The Conference participants discussed special features of organization of the system of public finance in EU and EE countries, sustainability of their fiscal policy, experience of implementation of performance budgeting, and special features of interbudgetary relations. In the course of the Conference, MFSI-II experts took part in proceedings of the Public Finance and Public Finance Management working group. Its members considered a number of topical issues related to changes in the fiscal policies in recent year and their impact on different countries, in particular, the experience of the Czech Republic in resource provision of local budgets, the present-day status and problems of Poland's tax system. Also, the participants raised a number of issues with regard to local budget management, in particular, Hungary's experience of local government borrowing, degree of decentralization and change in priorities of local budget expenditures in the EU Member-States, and other issues. For a more detailed coverage of the Conference click here.

The Project representatives made a presentation to the Conference participants about the implementation of budget reform in Ukraine, achievements of the MFSI and MFSI-II projects, in particular with regard to implementation of PPB at the local level and efforts of improving the energy efficiency in Ukrainian cities.

Study of international standards of public administration is extremely important for implementation of the reforms currently underway in Ukraine. The participation of Institute's experts in such events will make it possible to learn from best practices of EU Member-States and implement such practices in Ukraine.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On **3 July 2014**, MFSI-II experts held a meeting with representatives of the Reanimation Reform Package civic initiative and discussed possible areas of collaboration under MFSI-II Project.

On the same day, the MFSI-II experts took part in a meeting of the relevant Public Finance Reform working group organized by the Reanimation Reform Package initiative. The meeting focused on the topical issues of reform of the Ukrainian budget system. Among other things, under consideration were the matters of improving the control over efficiency of budget spending, increasing the transparency of the State and local budgets, mechanisms of conducting external independent audits of key spending units and budgetary institutions. In addition, the MFSI-II experts shared their experience of implementing PPB at the local level and provided their proposals with regard to key directions of the budget reform.

Subsequently, this effort will make it possible to build initiatives intended for improving budgeting

efficiency, increasing transparency of budgets, and reducing corruption in the budgetary sphere.

On 9 July 2014, experts of the MFSI-II Project took part in a meeting of the Reanimation Reform Package initiative devoted to the energy sector reform. The meeting participants noted an urgent need to take immediate steps at the legislative level with regard to strengthening the capacity of local budgets to reduce energy consumption. This need is prompted by the Government directive to cut consumption of natural gas.

One of the relevant areas in this effort, as noted by the meeting participants, is the need to make amendments to the Budget Code, which would empower budgetary institutions to make energy service contracts. The MFSI-II experts have been working on said amendments for more than a year now. They are currently passing through the approval process in key government ministries for subsequent submission for consideration of the Cabinet of Ministers of Ukraine. The meeting participants decided to join in actively in the elaboration of said legislative changes, in particular, through collaboration with the Ministry of Regional Development, Construction, and Housing and Communal Services.

Other possible actions noted by meeting participants include the need to introduce a system for evaluation of efficiency of expenditures for communal services and energy at the level of local budgets, and financial incentives for efficient use of energy resources. The MFSI-II Project is working on development of these methodologies. Implementation of these methodologies would allow local budgets to ensure clear and transparent controls over efficiency of energy consumption in the budgetary sector and reduce the amount of energy resources used.

On 16 July 2014, experts of the MFSI-II Project took part in a meeting of the Reanimation Reform Package initiative devoted to the energy sector reform.

The meeting was attended by representatives of the academia, experts, and civic activists. The participants in the event presented their joint proposals with regard to changes in the legislative drafts related to reduction of energy consumption and rational use of energy resources. The attendees showed interest in the methodological developments of the MFSI-II Project experts with regard to the system for evaluating efficiency of expenditures for communal services and energy, and financial incentives for efficient use of energy resources. They have also stressed an urgent need to build a consolidated nationwide system of energy conservation and the need to amend the Energy Strategy of Ukraine for up to the Year 2030.

In addition to the issue of reducing energy consumption, the meeting also considered other options for conservation of energy resources, such as alternative and renewable sources of energy.

Implementation of the abovementioned actions will make it possible for local budgets to efficiently use their energy resources and will promote lowering of energy intensity of the Ukrainian economy in general.

On 22 July 2014, the MFSI-II Project took part in the Public Private Partnership Development - New Opportunities for Economic Development roundtable discussion. The roundtable was hosted by the USAID-funded Public Private Partnership Development Program (P3DP) and the Verkhovna Rada Committee on Entrepreneurship, Regulatory, and Antimonopoly Policies.

The meeting was attended by representatives of the Verkhovna Rada, the Ministry of Economic Development and Trade (MEDT), local government, business community, NGOs, scholars and members of the press.

The roundtable focused on the current status of the legislation regulating public private partnerships and the bill "On Amending Certain Legislative Acts of Ukraine (on the removal of regulatory barriers to development of public private partnerships in Ukraine and promoting investments)" dated 3 July 2014, No.4267A sponsored by a group of Verkhovna Rada deputies: Oleksandra Kuzhel, Oleksandr Koval, and Yuriy Derevyanko.

The bill was prepared by a working group made up of P3DP, MEDT, and others.

At the meeting, the participants discussed and approved proposed amendments to the bill, namely, with regard to the removal of regulatory barriers to PPP development.

If approved, the legislative amendments would remove barriers to the implementation of basic PPP formats, provide for the effective implementation of PPP mechanisms, and help create a conducive, transparent environment for PPP implementation which, in turn, will stimulate investment into Ukraine.

On 6 August 2014, the MFSI-II Project took part in a weekly meeting of the Reanimation Reform Package initiative devoted to energy sector reform.

The meeting's participants included energy efficiency experts, activists, scholars, specialists from International Finance Corporation, and representatives of Verkhovna Rada Committees.

The meeting focused on key issues for creating a favorable environment for energy consumption, including, among others, the obligatory installation of metering devices, transparent and clear tariff formation, introduction of energy manager positions in all local governments, and establishing a single agency to develop a State policy of energy conservation and energy efficiency.

Also, the participants stated their support for the prompt adoption of legislative drafts that would allow private capital to be engaged in energy saving activities in the budgetary sector by means of attracting energy service companies. The Project, among others, took an active part in developing these legislative drafts.

The implementation of these tasks would help reduce the cost of thermal modernization projects, promote energy conservation, and reduce energy consumption.

On 26 August 2014, the MFSI-II Project took part in a regular meeting of the Reanimation Reform Package Initiative, which focused on energy sector reforms.

At the meeting The Project delivered a presentation and discussed the priority tasks of reducing the general energy intensity of the Ukrainian economy. The essential activities include the following:

– set up a single agency and system of formation and implementation of the national energy efficiency and energy conservation policy with appropriate powers;
– introduce the institution of energy managers;
– the forbid sale of energy resources without metering devices installed starting in 2015;
– develop a system of financial, administrative, and behavioral incentives for energy saving activities;
– set up an Energy Efficiency and Energy Conservation Fund;
– introduce a clear and transparent tariff setting;
– stimulate reduced consumption rather than generation etc.

In addition, the Initiative's members contributed their proposals and comments to the Law of Ukraine "On the Principles of Operation of the Electric Energy Market of Ukraine" dated 24 October 2013, No. 663-VII. The modifications made, in turn, will provide for a fair allocation of funds, development of electric generation facilities, and general infrastructure.

Implementation of the abovementioned tasks will create a favorable environment for sound energy consumption and energy conservation.

On 24 September 2014, the MFSI-II Project took part in a meeting of a international technical assistance panel organized as part of the Responsible, Accountable, Democratic Assembly (RADA) Program supported by the United States Agency for International Development (USAID).

The event was attended by representatives of the Association of Ukrainian Cities, and other projects financed by USAID.

The attendees heard a presentation given by the Association of Ukrainian Cities on the draft amendments to the budget and tax legislation submitted to the Verkhovna Rada. The participants were familiarized with the key provisions of the legislative drafts prepared by the Government, and had an opportunity to examine the need for making such amendments. Special focus was on local budgets and

issues of strengthening the financial capacity of local governments.

The issues highlighted are extremely important for the reform of the Ukrainian government in general and should be taken into consideration when implementing the reform of the Ukrainian budget system.

The Government Committee on Regional Development approved draft legislative amendments, including amendments to the Budget Code, that provide the legal grounds for implementing ESCO mechanisms in Ukraine. The committee also directed the Interdepartmental Working Group to finalize those amendments with due account given to the input of interested government ministries and the Legal Department of the Cabinet of Ministers of Ukraine.

Result: Preparation and organization of Financial-Economic Forum
Deliverable: Minutes of Financial-Economic Forum, agenda and recommendations of Forum participants
Timeline: February 2014, September 2014

The Financial and Economic Forum was postponed to the fourth quarter of 2014.

Result: Preparation and organization of a National Advisory Board
Deliverable: Minutes of a National Advisory Board and agenda
Timeline: December 2013, March 2014, June 2014, August 2014

On December 24, 2013, the National Advisory Board (NAB) held a meeting on effective pubic finance management. The representatives of the Ministry of Finance of Ukraine, State Treasury Service of Ukraine, local financial authorities, scientific circles, international expert environment, public sector and other leading experts in the sphere of regional and local development participated in the meeting.

Within the meeting, the participants approved the offers of MFSI-II experts aiming at improving the PPB methodology and legislative basis. These changes will allow settling problems, which may arise when forming local budgets based on the PPB.

Meeting of the National Advisory Board (NAB) on efficient management of public finance, 24 December 2013

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

On 6 June 2014, a meeting of the National Advisory Board (NAB) on efficient public finance management took place. The meeting was held as part of the Municipal Finance Strengthening Initiative Project (MFSI-II) Roll-out and was attended the MFSI-II Project as well as the Ministry of Finance of Ukraine, State Treasury Service of Ukraine, academia and the international expert community.

At the meeting, the participants discussed the new budget policy directions for the year 2015 and proposals for improving the methodological and regulatory framework for PPB budgeting. Special focus was placed on amending existing normative acts that are directly linked to the budget process and are to be used for forming and executing local budgets based on the Performance Program Budgeting method. Also, the Project suggested certain opportunities for providing for the needs of budgetary institutions in implementing their energy saving activities. Providing for these needs will help engage energy service companies in the implementation of energy performance projects, which in turn will make it possible to save budget funds.

Meeting of the National Advisory Board (NAB) on efficient management of public finance, 6 June 2014

In addition, Project proposals for amending the Budget Code of Ukraine were considered. Such amendments are intended to introduce the terms for long-term obligations and related procedures. As the result of the discussion, the participants approved the Project's proposals and groundwork.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

On September 29, 2014 the National Advisory Board (NAB) held the meeting on effective pubic finance management in the framework of the Municipal Finance Strengthening Initiative (MFSI-II) Roll-Out. The representatives of the Ministry of Finance of Ukraine, State Treasury Service of Ukraine, Committee of the Verkhovna Rada on budget issues, local financial authorities, academia and the international expert community participated in the meeting

Meeting of the National Advisory Board (NAB) on efficient management of public finance, 29 September 2014

At the meeting the participants discussed key provisions of the Draft Law on Changes to the Budget Code of Ukraine (as regards international relations reform) and the Draft Law on Changes to the Tax Code of Ukraine. The representatives of the local financial authorities expressed their opinion on how legislative initiatives influence the development of local governments on the local levels. The members of the meeting noted that authority decentralization and local government reforming would promote opportunities and increase resources of territorial communities, and contribute to better territory development and welfare.

Based on the discussion results, the members of the meeting decided to prepare and provide the interested parties with the advice on further improvement of legislative standards.

See folder "Deliverables"

Result/Deliverable: Regular updating of IBSER's website with information regarding project activities
Timeline: Ongoing process

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II project experts participated in the period October – December 2013 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (electronic versions), prepared in the period October – December 2013, have been placed on the site in the Subsection – "Analytical materials" (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in October – December 2013 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

New set of questions in section "Experts' answers" with experts answers related to PPB section has been regularly added on the site, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

Accomplished (see "Quarterly Report 01 October – 31 December, 2013")

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II project experts participated in the period January – March 2014 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (electronic versions), prepared in the period January – March 2014, have been placed on the site in the Subsection – "Analytical materials" (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in January – March 2014 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

The IBSER's Facebook page is updated and all news and photos from events and workshops were placed.

New set of questions in section "Experts' answers" with experts answers related to PPB section has been regularly added on the site, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II project experts participated in the period April – June 2014 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (electronic versions), prepared in the period April – June 2014, have been placed on the site in the Subsection – "Analytical materials" (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in April – June 2014 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

The IBSER's Facebook page is updated and all news and photos from events and workshops were placed.

New set of questions in section "Experts' answers" with experts answers related to PPB section has been regularly added on the site, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II project experts participated in the period July – September 2014 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (electronic versions), prepared in the period July – September 2014, have been placed on the site in the Subsection – "Analytical materials" (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in July – September 2014 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

The IBSER's Fecebook page is updated and all news and photos from events and workshops were placed.

New set of questions in section "Experts' answers" with experts answers related to PPB section has been regularly added on the site, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

Result: Preparation of Electronic bulletin intended for the publication of news on project activities for electronic mailing to addressees in the database of IBSER partners
Deliverable: Electronic bulletin
Timeline: October 2013, January 2014, April 2014, July 2014

One Bulletin issue (#42 April – June 2014) has been prepared in Ukrainian and English and e-mailed to more than 665 partners. It is also placed on the project web-site in the "E-Bulletin" section. Overall, nine Bulletins have been prepared since the launch of the MFSI-II Project.

See folder "Deliverables"

Result/Deliverable: Publication «Innovative Practices of the Local Finance Management».
Timeline: March 2014

MFSI-II experts have prepared an annual publication of *Innovative Practices: Local Finance Management – 2013 Results*, which provides illustrations of the results of execution of budget programs and energy performance projects, and highlights the successful experience of realization of strategic programs and PPB implementation. The publication is intended for a wide audience and is expected to help popularize the achievements and best practices of PPB at the local level.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

Result: Support the holding of separate information public events in partner cities
Deliverable: The report on implementation of information public events in localities prepared
Timeline: February 2014, August 2014

27 March 2014 IBSER took part in a roundtable discussion on the Results of Executing the Stryi District 2013 Performance Program Budget, which was held in the city of Stryi, Lviv Oblast. The roundtable was attended by representatives of the district's key spending units and NGOs.

The results of executing the district's budget based on the Performance Program Budgeting method were discussed at the meeting.

Stryi District was one of the first to launch a pilot project on PPB implementation in local budgets. All the key spending units of the district budget have mastered the PPB methodology fully and carry out budget program efficiency evaluations. Based on these evaluations, the district leadership makes the appropriate management decisions. In particular, the roundtable participants discussed the performance of the Culture Department. The analysis of the Library program's performance has made it possible to optimize the staffing of the district's libraries.

Special focus was made on the results achieved thanks to implementing energy saving activities, which provided real savings of budget funds.

Based on the roundtable's results, proposals have been made for improving the methodology for local-level Performance Program Budgeting. The key proposals consist of the need to amend the Standard Lists of Budget Programs and their Performance Indicators by department. This primarily applies to the Education and Culture departments.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")

A roundtable on the topic of Implementation of the Performance Program Budgeting Method in Ivano-Frankivsk was held with support from the Institute for Budgetary and Socio-Economic Research in

Ivano-Frankivsk on **24 June 2014**. This public event was attended by representatives of the City Council, key spending units of the municipal budget, and members of the press.

In the course of the meeting the participants discussed the general issues of PPB implementation, characterized the effectiveness of using the budget funds, shared their experiences of formulation of budget programs, and described the benefits from conducting the performance monitoring and evaluation.

Conducting a public discussion of the above issues will make it possible to improve the transparency of municipal budget execution and inform the public about the results of conducting the experiment of PPB implementation.

Performance Program Budgeting Method in Ivano-Frankivsk Roundtable, 24 June 2014

Accomplished (see "Quarterly Report 01 April 2014 - 30 June 2014")

Experts of the MFSI-II Project took part in a USAID Field Day information fair in Lviv on **24 August 2014.** The event was organized by the United States Agency for International Development (USAID) and was devoted to the Ukraine Independence Day celebrations.

The event participants included projects and organizations, which collaborate with USAID and implement projects both in Lviv and in neighboring local communities

Visitors to the fair learned from the MFSI-II Project experts about the principles of municipal budget formation and the benefits of using the Performance Program Budgeting method in the budget process, received professional advice on energy conservation and energy efficiency, and were familiarized with practical steps on how they could influence the formation of their municipal budget.

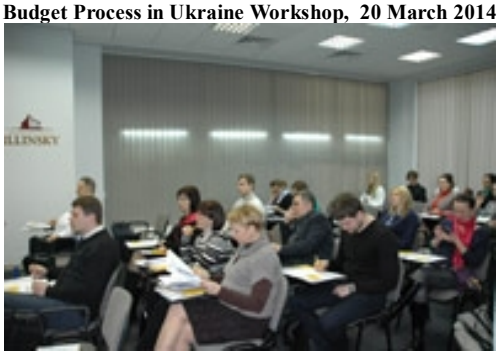
USAID Field Day Information Fair in Lviv, 24 August 2014

Result: Delivery of training on budget issues for NGOs
Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender
Timeline: January – March 2014

MFSI-II experts delivered a Budget Process in Ukraine workshop **on 20 March 2014**. Attendees included representatives of 16 non-governmental and public organizations, as well as independent experts.

The workshop focused on the way the budget system works in Ukraine. Due to the complexities of the legislation, the general public and "non-experts in the budget process" have insufficient knowledge of the budget process in Ukraine. This is primarily due to the lack of information in a demonstrative/simple format. This lack of awareness impedes the engagement of citizens and public organizations in the budget process as well as the ability to require accountability at all levels of government. At the same time, it is the proactive participation of the general public that will ensure the improved efficiency of government operations, better process transparency, reduction of corrupt practices, as well as the effective and rational use of taxpayers' money.

Budget Process in Ukraine Workshop, 20 March 2014



In order to assure the effective engagement of the general public and NGOs in the budget process, MFSI-II familiarized the participants with the phases of the budget process in Ukraine, explained the key concepts of the budget system, described the legislative and regulatory framework and budget classifications, as well as highlighted the special features of budget formation based on the Performance Program Budgeting method. This knowledge will help improve the preparedness of civil society organizations to act as participants in the budget process and overseers of budget transparency and accountability.

Accomplished (see "Quarterly Report 01 January 2014 - 31 March 2014")