PD-ABZ-736

BearingPoint

Ukraine Bank Supervision Development
Contract #PCE-I-00-99-00006-00 TO#827
Quarterly Report
July 1, 2003 to December 31, 2003

I.	**The NBU Bank Supervision Department evolves its processes so that risk-based supervision becomes the basis for both its inspection and enforcement. The following aspects of bank supervision are modified to reflect the new emphasis on risk-based supervision.**

1. **On-site Inspection: BSD staff is expert, not only in financial analysis (as is presently the case), but also in analysis of how adequate the banks' risk management systems are, in light of current and foreseeable risks that the bank faces with its current and prospective range of services. Written examination procedures place greater emphasis for the risk-management system. The "CAMELS" and "report of examination" -- for each bank examined – reflect the NBU's evaluation and recommendations for correction of any weaknesses found in the bank's risk management system.**

By September 30, 2003

Working with the Risk Based Supervision Task Force (Task Force), assist in the development of courses, implementation and delivery of the RBS training plan (a subset of the RBS implementation plan). The RBS training plan covers the remainder of the calendar year 2003 and all of 2004. Advisors: Antonova, All; NBU Counterpart: Task Force

According to the RBS training plan developed earlier, technical training for trainers (who will deliver regional RBS training throughout 2004) started on November 10 and continued for two weeks. At this time, the pilot seminar for GDBS Central Office personnel was scheduled for February 2004. BearingPoint RBS training was coordinated with Dutch Grant training events, and as a result potential RBS trainers from the NBU will be scheduled to attend Train-the-Trainers courses organized and delivered by Dutch Grant at three different locations.

In the meanwhile, BearingPoint continued course development efforts, and assigned advisors and counterparts responsible for the development of particular course components and topics. This effort will continue throughout our project duration. We envision different instructors to participate in each of the training seminars, thus organizational efforts will be an ongoing aspect of this project. We coordinated course delivery and logistics with the NBU's Personnel Department and the GDBS Training Unit Manager, Ms. Tatyana Khimich.

Working with the Task Force, implement the recommended schedule (developed in September 2002) to review chapters of the Onsite Manual to focus and emphasize the evaluation of banks' risk management system and results of the Risk Assessment System (RAS). Begin the review of

chapters based on an approved (by Task Force) schedule. This process will continue through 2004 and into 2005. Advisors: Ladokhina, Baranovich, Blimling; NBU Counterpart: Task Force

Since the Risk Assessment System (RAS) is to be officially approved in early 2004, the Task Force (primarily the Small Working Group) has focused its work on further developing the RAS. Thus, the implementation of the review schedule for the Onsite Manual is postponed until the beginning of 2004. In the meantime, both Ukrainian and English versions of the Manual were reviewed and adjusted in order to properly mirror each other.

By December 31, 2003

Finalize changes to the Report of Examination, CAMELS Policy, Supervisory Strategies and other communication tools to reflect the results of RAS. Advisors: Kutsenko, Blimling, Wilson; NBU Counterpart: Task Force

The Risk Assessment System was finalized after the Train-the-Trainers session held in November. Per NBU's decision, the RAS will be introduced as a separate section of Onsite Manual in early 2004. Such section will be mandatory for examiners to use, but will have limited effect on banks in case a deficiency is found as this remains a pilot program. In addition, before October 2004 the regional examiners will have to submit to the Task Force their comments and suggestions to fine-tune the RAS and support it full implementation in 2005.

The Report of Examination format will remain unchanged until the pilot program nears its completion. After every risk-based exam the examiners will produce separate memos for each risk category, together with assessment factors and risk matrices supporting the conclusions. The reason for such decision is that the NBU has not had a chance to test the proposed Report of Examination format at any examination. Such tests will be done during training and follow-up examinations. Only once NBU has collects practical experience in using RAS the amendments to Report of Examination will come into effect.

Continue to assist the Task Force in the implementation of RBS training plan. Advisors: Antonova, All; NBU Counterpart: Task Force

The technical training for the potential instructors of RBS seminars was held November 10 through November 21, 2003. Twenty participants finished the seminar. Course material included brief presentations on Risk Based Supervision, Risk Management Systems, Corporate Governance and included completion of an extensive case study.

The RBS pilot seminar for GDBS personnel scheduled for December 2003 was postponed because of delays in developing the Minimum Guidelines for Risk Management Systems in Commercial Banks. The delay gave BearingPoint and the NBU sufficient time to develop the most appropriate format of training and finalize all training materials. The seminar is slated for next quarter.

Continue development of the Onsite Manual and other supervisory tools. Assist in the issuance of revised Chapters of the Onsite Manual. Advisors: Ladokhina, Baranovich, Blimling; NBU Counterpart: Task Force

Recommendations were presented to the NBU on the Onsite Manual review, focusing on the following: 1) to publish and practically implement the chapters developed earlier, used informally, but not officially adopted; 2) to expand the Onsite Manual into a Banking Supervision Manual, specifically, by including a chapter on Offsite Analysis; 3) to review the Manual in order to make the terminology consistent with the Risk Assessment System and Policy Guidelines for Comprehensive Risk Management Systems in Banks; and, 4) to make sure that corporate governance principles are adequately reflected in the Manual.

By March 31, 2004

Continue to assist the Task Force in the implementation of RBS training plan. Advisors: Antonova, All; NBU Counterpart: Task Force

Continue the development of the Onsite Manual and other supervisory tools. Assist in the issuance of revised Chapters of the Onsite Manual. Advisors: Ladokhina, Baranovich, Blimling; NBU Counterpart: Task Force

By June 30, 2004

Continue to assist the Task Force in the implementation of RBS training plan. Advisors:Antonova, All; NBU Counterpart: Task Force

Continue the development of the Onsite Manual and other supervisory tools. Assist in the issuance of revised Chapters of the Onsite Manual. Advisors: Ladokhina, Baranovich, Blimling; NBU Counterpart: Task Force

2. Offsite Analysis: MIS reports modified, based on the risk-assessment methodology. External audit results incorporated into the supervisory strategy of banks.

By September 30, 2003

Continue to assist the BSD in developing their supervisory strategies for banks to include results of the internal/external audits. Advisors: Kutsenko; NBU Counterpart: Ivanenko, Faber

We did not perform activities in this area during this quarter.

By March 31, 2004

Make recommendations and assist in implementation of changes and additions to reporting requirements subsequent to finalizing the RAS. Advisors: Kutsenko, All; NBU Counterpart: Task Force

3. Licensing: Requirements for both renewal and new bank licenses are changed to require risk management systems that meet NBU standards.

By September 30, 2003

Continue work with the Legal Department in the development of a licensing framework needed to ensure commercial banks appropriately address the Risk Management System functions at the time of licensing. Advisors: Gegenheimer, Telychko; NBU Counterpart: NBU Legal Department, Parkhomenko

Draft amendments to the Law on Banks and Banking have been developed. Articles 17-20 address issues related to licensing. The amendments are to be considered during round table discussions with the Legal Department by December 31, 2003.

By December 31, 2003

Continue work with the Legal Department in the development of licensing framework needed to ensure banks appropriately address the Risk Management System functions at the time of licensing. Advisors: Gegenheimer, Telychko; NBU Counterpart: NBU Legal Department, Parkhomenko

Due to reasons beyond our control, working group on amendments to BBL related to issues of Risk Management systems (including addressing the RMS functions at the time of licensing) has not been formed yet, and it is supposed to start its activities only in early 2004. Please see comments in Section 5 "Legal Issues".

By March 31, 2004

Assist in the development of amendments of appropriate licensing regulations to implement revised laws. Advisors: Gegenheimer, Telychko; NBU Counterpart: NBU Legal Department, Parkhomenko

By June 30, 2004

Continue assisting in the development of amendments of appropriate licensing regulations to implement revised laws. Advisors: Gegenheimer, Telychko; NBU Counterpart: NBU Legal Department, Parkhomenko

4. Organization and Staffing: Supervisory personnel are trained in risk-based management. The organizational structure of the Bank Supervision Department will be reviewed and changed to reflect the evolution of risk-based management.

By September 30, 2003

Work with the Task Force, NBU Personnel, and World Bank/Dutch Grant project in developing and implementing RBS training to begin in late 2003 and continue throughout 2004. Advisors: Antonova, All; NBU Counterpart: Task Force, NBU Personnel Department

Organization of course delivery and logistics is being coordinated and discussed with the Personnel Department and GDBS Training Unit. Personnel Department and GDBS will assist BearingPoint in selecting RBS instructors from the NBU. Most of these potential instructors will attend Dutch Grant's Train-the-Trainers course (Presentation Skills). Technical training for the RBS trainers will commenced on November 10, 2003.

Continue efforts to organize and deliver various work/study and training opportunities in Poland and the United States. Advisors: Antonova; NBU Counterpart: Ivanenko, NBU Personnel Department

A proposal was provided to Mr. Pushkariov on the selection of BSD personnel members for study tours in the United States.

With BearingPoint advisory assistance, Ms. Ivanenko, Deputy Director of the General Department of Banking Supervision, participated in the course development of a seminar ("Best Practices of On-Site Examinations: Regional Experience and Challenges" for CEE and former Soviet Union countries) organized by the Training Initiatives for Banking Supervision (TIBS) of the National Bank of Poland. This seminar will started on November 17, 2003. Ms. Ivanenko made presentations of the Ukrainian bank supervision experiences and challenges. Three other persons from the GDBS also attended this forum. BearingPoint advisors are working with the NBU and TIBS on the topic for a seminar that is scheduled for the May 2004, to be delivered in Kiev for the GDBS by TIBS instructors. These negotiations are nearing completion.

Another topic for discussion with the TIBS, NBU and BearingPoint is a potential visit of the GDBS Training Unit Manager to TIBS to discuss best practices, policies and approaches to organizing a self-sufficient and effective training function for the NBU bank supervision area.

Finalize proposal to provide English lessons for future participants in U.S.-based work/study program. Advisors: Ladokhina; NBU Counterpart: Faber, Ivanenko, Pushkayov

This issue has proven to be politically sensitive, and it was decided to postpone English classes until the BSD management specifically requests assistance for the participants of the study tour. The candidates are to be selected by the BSD management and in compliance with criteria stipulated in the proposal mentioned above.

By December 31, 2003

Continue the development and implementation of RBS training program. Advisors:Antonova, All; NBU Counterpart: Task Force, NBU Personnel Department

Training materials were developed and TOT RBS training was delivered in November 2003. A group of instructors from Kyiv and regions was selected by the NBU and BearingPoint to assist in the future implementation of RBS training. During the next quarter, BearingPoint will focus on formatting training materials and on the development of the best delivery mechanisms – combination of distance and classroom training. Selected individuals from TOT group will be heavily involved in the

development and then in the delivery of the RBS training. The first session of RBS training will be conducted in February, regional training will commence in March 2004.

Continue efforts to organize and deliver various work/study and training opportunities in Poland and the United States. Advisors: Antonova; NBU Counterpart: Ivanenko, NBU Personnel Department

In November 2003 several senior managers of the General Department of Banking Supervision participated in the seminar "Best Practices of On-Site Examinations: Regional Experience and Challenges" for CEE and former Soviet Union countries organized by the Training Initiatives for Banking Supervision (TIBS) of the National Bank of Poland. Ms. Ivanenko, Deputy Director of GDBS, delivered a training session on the Ukrainian bank supervision experience and challenges. GDBS used this opportunity to discuss future cooperation between TIBS and the NBU. BearingPoint will continue to facilitate cooperation between the NBU and the NBP in the area of delivery of the joint training programs. According to the NBU 2004 training plan, TIBS instructors plan to deliver a seminar on the Polish experience of risk-based and consolidated supervision. In addition, BearingPoint is discussing with TIBS a potential visit of the newly appointed Banking Supervision Training Unit Manager to TIBS to discuss best approaches to organizing an efficient training function for banking supervision area.

BearingPoint presented to the NBU the list of international training courses organized by OCC for bank supervision experts for 2004. If necessary, BearingPoint will facilitate participation of the GDBS experts in these training sessions in the United States. In the meanwhile, BearingPoint will continue to look into opportunities to organize and deliver a study tour/internship program for GDBS examiners in the United States.

Assist and facilitate the organization of English lessons for future participants in U.S.-based work/study program. Advisors: Ladokhina; NBU Counterpart: Faber, Ivanenko, Pushkayov

Please see above (September 30, 2003) for comments in this area.

By March 31, 2004

Continue the development and implementation of RBS training program. Advisors: Antonova, All; NBU Counterpart: Task Force, NBU Personnel Department

Continue efforts to organize and deliver various work/study and training opportunities in Poland and the United States. Advisors: Antonova; NBU Counterpart: Ivanenko, NBU Personnel Department

By June 30, 2004

Continue the development and implementation of RBS training program. Advisors: Antonova, All; NBU Counterpart: Task Force, NBU Personnel Department

Continue efforts to organize and deliver various work/study and training opportunities in Poland and the United States. Advisors: Antonova; NBU Counterpart: Ivanenko, NBU Personnel Department

Ongoing

As risk-based supervision is developed within the BSD, make recommendations to management concerning potential changes in organizational structure. (Continuation from year 1. Advisors: Blimling, Wilson; NBU Counterpart: Shlapak, Pushkayov

We provided assistance in the formation of a new department within the GDBS. The department combines the Methodology, the Economic Analysis, the Strategic Planning, and the Enforcement Actions Units into one department called the Department of Methodology and Strategic Planning. Ms. Svetlana Faber heads the new department and the previous units are now divisions with slight name changes. This reorganization results in having four departments reporting to Mr. Pushkayov rather than three departments and four units. Additionally, a new unit within the Methodology Division, called the Risk Based Supervision Unit, is to be formed. We will be working closely with this new unit in the development of the supervisory manual and other RBS tools.

5. **Legal Issues: Elements of the legal framework are further elaborated which deal with different aspects of the banks' required systems of risk management. In particular new implementing regulations are developed requiring risk-management units and board-approved risk limits within banks. An amendment to the Law on Banks and Banking is developed to require the internal auditors of commercial banks to report to the Supervisory Council of their bank (rather than, as currently required, to their Board of Management.)**[1]

By September 30, 2003

Working with the BSD and NBU Legal Department, assist in the development of amendments to the Law on Banks and Banking (and related laws) in order to improve the legal framework for implementing risk-based supervision and corporate governance in banks, using as a basis the areas identified in Year 1. Advisors: Telychko, Gegenheimer; NBU Counterpart: Ivanenko, NBU Legal Department

Since the NBU has decided to submit their proposed amendments to the Law on Banks and Banking in segments divided into defined topics, extensive working group meetings dedicated to specific issues have been conducted and will be conducted throughout this year and ext year.

[1] This section calls for the implementation of new laws and regulations, and amending current legislation. We feel that a thorough review of all pertinent laws and regulations, along with full agreement and cooperation from NBU Bank Supervision and Legal Departments are necessary before implementation can take place. Therefore, the actual implementation phase may only be accomplished after considerable research and consultation with NBU management and staff, and the banking industry. Our assistance in the development of Laws and Regulations will coincide with the NBU Comprehensive Program of the Development of the Ukrainian Banking System.

The first two working groups that took place in July-August were dedicated to external audit and beneficial ownership concepts. Participants of the working groups have accepted many of our recommendations. Even though the language has been considerably changed, approximately 80% of the underlying concepts were taken into consideration. The proposed amendments are to be approved by the NBU Council some time in mid-October and submitted to the Rada.

By December 31, 2003

Continue to assist in the development of amendments to the Law on Banks and Banking (and other laws). (This is in line with the "Comprehensive Program for the Development of the Banking Industry," which states the NBU will submit suggested amendments to the Rada by 12/31/03.) Advisors: Telychko, Gegenheimer; NBU Counterpart: Ivanenko, NBU Legal Department

We developed and distributed to all concerned parties within the NBU further recommendations on amendments to BBL in area of corporate governance and risk-management systems as well as in area of consolidated supervision.

Mr. Gegenheimer and Mr. Telychko held meetings with Ms. Faber, Mr. Novikov, Mr. Uvarov and other key personnel to discuss necessary amendments to BBL and reasons for so a slow process of making amendments. The major problems displayed are: 1) political reasons; 2) internal conflict between the Legal Department and General Department of Bank Supervision; 3) overload of the NBU legal department with other work while human resources are insufficient; 4) structural changes within the NBU; 4) intention to involve commercial banks in the process of discussing proposed amendments to the law (though, it is necessary since interests of banking community are strongly presented and lobbied in the Parliament); 5) changes in approaches related to forming package(s) of amendments. Due to above reasons, the work on amendments related to beneficial ownership concept and external audit is not finished yet, though relevant working groups started their activities in summer 2003. Working groups on other issues were not formed yet.

As of late December 2003, the NBU decided to provide recommendations on amendments to BBL in one comprehensive package that would incorporate recommendations related to beneficial ownership, audit, corporate governance, risk-management systems (including addressing RMS issues at the time of licensing and reinforcing the NBU authorities) and possibly consolidated supervision. The working group dedicated to those issues is supposed to start operation in early 2004. It is expected that actual amendments to BBL will not take place until end of 2004.

By March 31, 2004

Identify NBU regulations that need updating as a result of passage by the Rada the package of law amendments submitted in December 2003. (Of course, this assumes that the package actually is submitted by 12/31/03, and that the Rada actually passes it or passes something that reasonably resembles the package.) Advisors: Telychko, Gegenheimer; NBU Counterpart: Ivanenko, NBU Legal Department

By June 30, 2004

Provide specific suggestions for amendments to existing NBU regulations, or for new regulations, to implement suggestions in connection with findings of previous quarters. Advisors: Telychko, Gegenheimer; NBU Counterpart: Ivanenko, NBU Legal Department

II.	**The banking community understands and accepts risk-based supervision. The contractor will advise and assist the National Bank in the elaboration of regulatory standards and an action plan for implementation of risk-based supervision at the commercial banks.**

1. **Compliance: NBU BSD develops a plan for compliance with the new regulations on risk-based supervision.**

By September 30, 2003

Work with the Task Force to fully implement the compliance plan (part of RBS implementation plan developed in May 2003) by December 31, 2004. Advisors: Blimling, Wilson; NBU Counterpart: Task Force

Discussions were held with key members of the Task Force on how to proceed with the implementation of the compliance plan. More specific details and recommendations will be forthcoming in the next quarter.

By December 31, 2003

Continue Working with the Task Force to fully implement the compliance plan by December 31, 2004. Advisors: Blimling, Wilson; NBU Counterpart: Task Force

Discussions were held with Ms. Faber concerning implementation of the Risk Based Supervision initiative. However, due to continued personnel changes within the bank supervision area and extensive holiday leave for major contributors to the initiative, little was formally decided. Ms. Faber intends to begin the use of the Risk Based Supervision approach in 2004, but will not be able to work out all the details until early in January.

By March 31, 2004

Continue working with the Task Force to fully implement the compliance plan by December 31, 2004. Advisors: Blimling, Wilson; NBU Counterpart: Task Force

By June 30, 2004

Continue working with the Task Force to fully implement the compliance plan by December 31, 2004. Advisors: Blimling, Wilson; NBU Counterpart: Task Force

2. **Diagnostic: NBU Bank Supervision Department (BSD) reviews the main products and services of a sample of the two tiers of larger banks (about 25 banks, accounting for**

over three-fourths of banking system assets) and assesses the types of risks relevant for each.

By March 31, 2004

Assist Task Force in developing a process that will allow the BSD to maintain timely information on existing and new products that commercial banks offer. Advisors: Blimling, Wilson; NBU Counterpart: Task Force

By June 30, 2004

Assist Task Force in the implementation of a process that will allow the BSD to maintain timely information on existing and new products that commercial banks offer. Advisors: Blimling, Wilson; NBU Counterpart: Task Force

3. **Template: NBU BS develops a template covering the panoply of risks, and describes the key elements needed for an effective risk management system.**

By September 30, 2003

Assist the Task Force in finalizing the testing of the Risk Assessment System (RAS) and provide a draft of policy guidelines for Risk Management Systems in Banks. Advisors: Blimling, Wilson, Vance, Ladokhina; NBU Counterpart: Task Force

The Risk Assessment System (RAS) was finalized by the Small Working Group of the RBS Task Force, based on the results of its pilot bank testing and further discussion by the Task Force, as well as taking into consideration comments and proposals of NBU branches and commercial banks. The RAS is ready to be approved by the Task Force and the NBU Board of Governors. A major change is the merging of the Operational and IT Risks into an Operations and Technology Risk category.

BearingPoint advisors drafted and submitted to the GDBS "Policy Guidelines to Risk Management Systems in Commercial Banks" based on best international practices. The Guidelines are to be finalized by the GDBS and officially issued by the end of 2003. To facilitate this, the GDBS established a Working Group that includes seven representatives of the NBU, seven representatives of commercial banks, and BearingPoint advisors. The objective of this Working Group is to finalize the Guidelines, taking into consideration comments and proposals of all interested parties (NBU units and branches, and commercial banks), and prepare a final official issuance.

By December 31, 2003

Assist the Task Force in finalizing the policy guidelines for Risk Management Systems in Banks. Advisors: Blimling, Wilson, Vance, Ladokhina; NBU Counterpart: Task Force

The policy guidelines remain in the final development stage. A working group made up of Task Force members and commercial bankers has been established and they are currently working to revise

the initial draft. It is anticipated a final draft that will be sent to all commercial banks will be issued early in the first quarter of 2004.

The Working Group for the development of the Policy Guidelines for Comprehensive Risk Management Systems in Banks gathered two times in October and November. At the first meeting, the Guidelines were presented, its purpose explained, and the input and comments requested.

At the second meeting in November, the inputs and comments of bankers were discussed. In particular, there were questions on the functions and responsibilities of the Risk Management Committee, the roles of the Supervisory Council, the Board of Managers, the ALCO, and internal audit. The NBU and BearingPoint position on these issues was presented to banks based on the principles of Corporate Governance. It was also suggested that for the next meeting the banks would present their ideas on the management of specific risks. The input of the banks has been received and is being summarized by the NBU and BearingPoint. The final discussion of this input and the meeting with the banks are scheduled for the middle of December and early January, respectively. After that it is planned that the Guidelines will be distributed for all banks and then in early 2004 passed as an official NBU document.

4. **Tools: NBU BS develops tools for the commercial banks in implementing "risk based" systems, such as examples of policies, audits programs, MIS software for implementation by individual banks.**

By March 31, 2004

Working with the Task Force, assist in the development of tools for commercial banks in implementing risk management systems. Advisors: Kutsenko, All; NBU Counterpart: Task Force

During the 3rd quarter of 2003 the draft "Policy Guidelines to Risk Management Systems in Commercial Banks" was prepared.

During 4th quarter of 2003 the above-mentioned policy was discussed with representatives of the most advanced banks, commented by them and edited to incorporate new ideas. It is expected that in early 2004 this policy will be introduced to banks.

By June 30, 2004

Working with the Task Force, assist in the development of tools for commercial banks in implementing risk management systems. Advisors: Kutsenko, All; NBU Counterpart: Task Force

5. **Risk-based Supervision Director and Committee: The NBU designate a small group of examiners to be responsible for risk management implementation ("Risk-Based Supervision Committee") and senior Bank Supervision Department Official ("Risk-Based Supervision Director"), who will be the NBU's primary liaison with the banks in the implementation of the new methodology. This group is responsible for training other NBU examiners in risk management, for reviewing implementation plans and**

policies, and for evaluating and providing on-site assistance regarding the procedures developed by individual banks.[2]

The Risk Based Supervision Task Force is established and fully functioning. This illustrative task is complete.

6. **Communication: NBU's "Risk-based Supervision Committee" develops seminars and prepares training materials to be made available to the banks as guidance on implementation of risk-based systems and the new NBU regulations in this area. (A policy manual should be given to the bankers by the NBU early in the process to provide this guidance and as a basis for discussion at meetings with senior bankers.)**

By September 30, 2003

Assist the Task Force in the development and delivery of training, outreach activities, and guidelines in their efforts to inform and assist commercial banks in their development of risk management systems (part of implementation plan developed in May 2003). Advisors: All; NBU Counterpart: Task Force

The NBU initiated an outreach session in late October for bank internal auditors. During this two-day session various issues were discussed, including the role of internal auditors in risk management and supervision-by-risk processes. BearingPoint participated in this outreach session by making a presentation covering "Basle Committee Requirements to Internal Auditors."

By December 31, 2003

Assist the Task Force in the development and delivery of training, outreach activities, and guidelines in their efforts to inform and assist commercial banks in their development of risk management systems. Advisors: All; NBU Counterpart: Task Force

BearingPoint advisors participated during the first two weeks of October in an NBU sponsored Risk Management Outreach initiative and two industry sponsored Internal and External Audit workshops.

By March 31, 2004

Assist the Task Force in the development and delivery of training, outreach activities, and guidelines to inform and assist commercial banks in their development of risk management systems. Advisors: All; NBU Counterpart: Task Force

By June 30, 2004

[2] Note: We have determined that a separate Director and Committee is not necessary since "Risk-based Supervision" is to become an integral part of all supervisory efforts. Instead, we are proposing that a task force be established that will guide the BSD through the implementation of "Risk-based Supervision".

Assist the Task Force in the development and delivery of training, outreach activities, and guidelines to inform and assist commercial banks in the development of risk management systems. Advisors: All; NBU Counterpart: Task Force

7. **Role of external and internal auditors: The NBU, through its regulations and its inspection procedures, focus on getting the management and bank boards to more rigorously incorporate, in a systematic way, analyses and recommendations of the internal and their external auditors. (Substantial work is needed in this area. Regulation, certification, and actual practices of internal and external audit in Ukraine are very weak.)**

By September 30, 2003

Assist the NBU, by making recommendations to changes in laws, regulations, methodologies and/or practices, in strengthening commercial banks' internal and external audit function. Advisors: Kutsenko, Telychko; NBU Counterpart: Ivanenko, Faber

During the quarter, the NBU continued to work on issues related to external auditors. In particular, the Audit Certification Committee Policy has been adopted and the Committee established (based upon recommendations from Mr. Chuck Canfield, WB/DG Advisor). The Committee includes nine member: five representing NBU, four from the Audit Chamber, and one from the non-bank financial regulator agency. Mr. Pushkariov was named Chairman and Mr. Faber Deputy Chairman.

It is expected that one of the immediate decisions to be made by the Committee is how and when to start issuing new bank audit certificates and what to do with the ones that expire. This issue becomes extremely important since the majority of External Auditor certificates expire before May 2004, i.e. before the deadline for presentation of year-end audited financial statements to NBU and the general public. If the issue remains unresolved, many national audit companies will loose the authority to conduct audits, which may have an adverse impact on the quality of the remaining audits (remaining audit companies may not have sufficient resources to accommodate the clients previously serviced by formerly authorized audit companies).

The NBU is fully aware of this situation and has formed a Task Force with NBU experts, representatives of audit companies (both domestic and the Big Four), and BearingPoint advisors.

By December 31, 2003

Finalize assistance to the NBU in strengthening commercial banks' internal and external audit function. Advisors: Kutsenko, Telychko; NBU Counterpart: Ivanenko, Faber

The Certification Committee of the National Bank has established procedures for renewing expired and existing external audit certificates, as well as for granting certificates to new auditors (entry requirements). Both procedures require eligible candidates to be able to show knowledge of International Accounting Standards (IAS) by holding a trusted accounting certificate (ACCA, CPA, or its Russian language equivalent – CIPA). In this respect, we cooperated closely with other

USAID-funded project – Accounting Certification administered by Chemonics – to the mutual benefit of both projects.

It is expected that the work will be continued in mid-2004, once banks would submit their audited financial statements and the NBU will start checking their quality.

1.	**III. The NBU Bank Supervision Department implements an institutionalized program for training, career advancement and certification of bank supervision officials. The NBU Bank Supervision Department, USAID advisors, and World Bank advisors and instructors will work together to develop an integrated approach to establish a consistent and sustainable program for improved training and for "certification" of bank supervision personnel.**

By September 30, 2003

Continue working with the BSD and the NBU Personnel Department (and Dutch Grant/World Bank Project) in the development of a curriculum for core courses, including RBS. Advisors: Antonova; NBU Counterpart: Ivanenko, Personnel Department

A series of meetings were conducted with Dutch Grant/BankWorld representatives and BearingPoint on many issues related to the development of core course curriculum, including RBS course as one of the fundamental courses. All training initiatives of BearingPoint and BankWorld were coordinated to avoid overlapping situations. It was initially agreed that the Risk-Based Supervision course will be considered as one of the fundamental courses of the formal training program developed by the Dutch Grant in close cooperation with BearingPoint, who will be responsible for the delivery of this course in 2004 for the bank supervision staff of the NBU. Potential participation of BearingPoint staff in the delivery of BankWorld Train-the-Trainer course was discussed. As it was mentioned earlier, BearingPoint local RBS instructors (from the staff of the GDBS) will attend Dutch Grant/World Bank Train-the-Trainers courses offered at three different locations of the NBU.

By December 31, 2003

Assist in finalizing a curriculum for core courses, including RBS. Advisors: Antonova; NBU Counterpart: Ivanenko, Personnel Department

BearingPoint participated in all Train-the-Trainers courses organized by Dutch Grant representatives at three different locations of the NBU, and selected a group of potential instructors for its RBS training program. Then in November 2003 these instructors attended technical Train-the-Trainer RBS seminars organized by BearingPoint.

BearingPoint consultants participated in meetings of Dutch Grant consultants and Training Unit management and discussed issues related to finalizing core course curriculum, including RBS courses, organizing and implementing an efficient training function, developing unit's policies and procedures, job descriptions, organizational structure, training needs analysis processes, etc. We

agreed that BearingPoint would look into an opportunity to expose Training Unit manager to the Polish experience of organizing an efficient training function for banking supervision area.

2. **Trainers: A group of its seasoned bank supervisors become classroom trainers, as part of their regular duties.**

By September 30, 2003

Assist the BSD and NBU Personnel Department (and Dutch Grant/World Bank Project) in developing a Train-the-Trainer program as part of the formal training program. Advisors: Antonova; NBU Counterpart: Ivanenko, Personnel Department

We provided assistance to Dutch Grant/BankWorld. Potential participation of BearingPoint staff in the delivery of Train-the-Trainers course was discussed.

By December 31, 2003

Assist the BSD and NBU Personnel Department (Dutch Grant/World Bank Project) in finalizing a Train-the-Trainer program as part of the formal training program. Advisors: Antonova; NBU Counterpart: Ivanenko, Personnel Department

BearingPoint continued to provide assistance to Dutch Grant/Bankworld in this sphere. BearingPoint participated in all three TOT courses delivered by BankWorld and contributed to course development and delivery.

3. **Certification: The NBU develops minimum qualifications for certification of fully qualified bank supervisors. The certification process should include: satisfactory completion of a set of core courses, normally to be taken by BSD bank supervision staff (from Kiev and regions) during their first three years in the Department; successful ratings by supervisors for the candidate's experience of having worked for certain periods of time in specified fields of responsibility of the Department (e.g. on-site exams, off-site supervision, licensing, registration); a passing score on an objective Certification Test that the BSD will administer from time to time.**

By December 31, 2003

Develop concept paper to provide guidance in the development of an appropriate regulation to institutionalize an accreditation process. Assist in the development of the regulation. Advisors: Ladokhina, Telychko; NBU Counterpart: Ivanenko, NBU Personnel Department

Due to conflicting schedules, we postponed this activity until the next quarter.

By June 30, 2004

Present to the BSD and the NBU Personnel Department a detailed proposed accreditation program based on the newly created regulation. Advisors: Ladokhina; NBU Counterpart: Ivanenko, NBU Personnel Department.

IV. Surveys and Assessments.

1. **Survey of Gender Composition of staff, with indications of supervisory and non-supervisory personnel.**

   Complete - Survey officially submitted in September 2002 to USAID in Kiev. (A similar survey is to be repeated by June 30, 2005.)

2. **Assessment of the NBU's operational implementation of Basle Core Principles, subject to agreement by the NBU.**

   Complete – Assessment officially submitted in July 2003 to USAID. (A similar assessment is to be completed in by June 30, 2005.)

3. **Obtain an average examination rating of the "M" component of CAMELS for Tier I and Tier 2 banks.**

   Complete – Information officially submitted in July 2003 to USAID. A similar determination is to be conducted by June 30, 2005.

Outside Contacts (for quarter ending December 31, 2003)

Advisor	Organization	Contact Name	Time
Alex Kutsenko	USAID	Victor Verhun	4 hours
	Donor Task Force on Audit Issues	Yevgeniya Malikova (USAID)	2 hours
	Chemonics	Barry Pitts	1 hour
	U.S. Treasury	Mel Brown	2 hours
	Extra-Consulting	Vlad Kartavtsev	2 hours

Advisor	Organization	Contact Name	Time
Maryna Antonova	USAID	Victor Verhun	8 hours
	Dutch Grant	Jim Crozier	80 hours

Other Work Requested By NBU

NBU has finalized new accounting framework and valuation policy regarding bank investments into securities. The advisors were asked to comment of the final drafts and help NBU in presenting new documents to commercial banks.

In addition, Mr. Kutsenko was asked to make a presentation on 2nd International Conference on Bank Risk Management held by Extra-Consulting together with prominent banks.