



**Financial Markets International, Inc.**

U S A I D Capital Markets Consultants in Ukraine

PD-ABR-241  
100766

## **Ukraine**

**June 1996 - June 1998**



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# Financial Markets International, Inc.

## Ukraine Assistance to the Securities and Stock Market State Commission

### Foreword and Acknowledgments

The Assistance to the Ukrainian Securities and Stock Market State Commission (SSMSC) project was financed by the United States Agency for International Development (USAID). The project was designed to assist the development of the administrative, organizational, and regulatory capacity of the Commission, and to develop the legal and regulatory framework of Ukraine's capital markets.

Financial Markets International, Inc. (FMI) values the dedication and excellent work of its staff and consultants who made this project succeed. FMI also gratefully acknowledges the support and cooperation it received from the Commissioners and staff of the SSMSC. Finally, FMI's work was greatly facilitated by the project management skills of Stephen Hadley, Michael Kaiser, Hugh Haworth, and Victor Stetsenko of USAID/Ukraine.

Respectfully submitted,

Financial Markets International, Inc.  
August, 1998

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## Financial Markets International, Inc.

### Executive Summary

In 1991, the Government of Ukraine (GOU) became independent of the Soviet Union and embarked on the difficult and sometimes painful transition from a command economy to a market economy. One important aspect of this economic transition was the decision by the GOU to create its own capital markets infrastructure by passing the laws "On Business Associations," and "On Securities and the Stock Exchange." These two laws established the basic principles of securities markets in Ukraine, and were the starting point for the GOU's ambitious effort to create in a few years what it took other countries decades to accomplish.

In 1995, the United States Agency for International Development (USAID) decided to increase its support for the accelerated development of a market economy in Ukraine. Already providing assistance to the GOU for its Mass Privatization Program, USAID added assistance for projects related to the formation of the Securities and Stock Market State Commission (SSMSC), an over-the-counter trading system (PFTS), and other capital markets institutions.

Financial Markets International, Inc. (FMI) was selected in June, 1996 by USAID to assist the development of capital markets structures in Ukraine, working with and through the SSMSC. FMI's specific tasks included:

- (1) Developing the SSMSC's organizational, administrative, and regulatory capacity,
- (2) Improving the legal and regulatory framework of the securities markets, with particular focus on
  - (a) corporate governance through corporate disclosure in accordance with internationally accepted laws and accounting standards,
  - (b) drafting and gaining Parliamentary approval of new laws and amendments to existing laws governing the capital markets,
- (3) Regulating market participants including SROs, securities traders, registrars, custodians, depositories, and investment funds, and
- (4) Implementing an active training program for the SSMSC, market participants, issuers, and the general public on all aspects of the securities markets.

In addition to assisting the SSMSC in the above areas, FMI was tasked with implementing a corporate governance training program, beginning in October 1996. Because of several investor disputes related to the issue of the dilution of shareholder rights through unlawful corporate governance practices, FMI was asked to assist in

educating GOU officials, capital markets participants, and the general public on critical issues of financial disclosure and shareholder rights. The main elements of this program, which expanded in 1997-98, included

- (1) Educating company management on corporate governance "best practices" and shareholders rights,
- (2) Assisting in the preparation of annual reports in accordance with internationally accepted laws and accounting standards, and
- (3) Assisting in the preparation of all corporate governance documentation such as notices of annual general meetings and proxies

When USAID began its assistance to the Securities Commission, there were a total of 5 SSMSC employees. There are now over 550 capable employees in the central and 25 regional offices. The SSMSC today has broad authority over the entire securities markets, including authority to issue regulations, establish public disclosure practices, and sanction market participants for improper conduct (*See Appendix 1 for Organizational Chart*)

FMI is pleased to have helped develop the technical capacity of the Commission and the legal and regulatory framework for securities markets in Ukraine over the last two years. Moreover, FMI is proud of its effective efforts to help create an environment in which shareholder rights and financial disclosure are taken seriously. Some noteworthy FMI accomplishments include the following:

- Drafted and secured approval by the SSMSC for over 40 securities market regulations and instructions
- Developed market surveillance and disclosure methodologies and assisted the SSMSC in reviewing issuer filings,
- Assisted the SSMSC in opening a Public Information Office (the first such office in the former Soviet Union) which made issuer filings and annual reports available to the general public,
- Assisted the SSMSC in holding a high-level corporate governance conference to address Ukraine's current problems and methods of remedying them,
- Conducted 17 major seminars across Ukraine for issuers, arbitration court judges, professors of economy and law, and journalists,
- Conducted 3 one-week long joint training seminars for SSMSC employees from all regional offices,
- Produced 11 brochures and manuals on the stock market and shareholders' rights, and distributed over 7 million copies to Ukraine's citizens,

- Provided content for 32 television infomercials, 33 radio shows, and numerous press and news services on all aspects of the capital markets and shareholder rights,
- Actively participated in the formation and implementation of a corporate governance task force in accordance with the Memorandum of Understanding (MOU) between Ukrainian Vice Prime Minister Tyhypko and U S Ambassador Morningstar. The MOU focused mainly on issues regarding corporate governance and international accounting standards (*See Appendix 2 for text of the MOU*)

Much remains to be accomplished in order to achieve fair, transparent, and sound capital markets in Ukraine. However, important steps in the right direction have been taken by the GOU with the assistance provided by USAID. This report reviews the effective efforts and accomplishments of USAID and FMI, working in collaboration with the SSMSC and other capital markets participants, to assist this development process from June, 1996 to June, 1998.

## **Ukraine Assistance to the Securities and Stock Market State Commission**

### **I Introduction**

Pursuant to the 1991 law ‘ On Securities and Stock Exchange ’ authority to regulate the securities markets was vested in the Ministry of Finance in Ukraine. The Securities and Stock Market State Commission (SSMSC) was established by Presidential Decree in July 1996, but was not given full authority over the securities markets until passage of the law ‘ On State Regulation of Securities Markets in Ukraine ’ in December 1996. The SSMSC now has broad authority over the entire securities markets, including authority to issue regulations, establish public disclosure practices, and sanction market participants for improper conduct. FMI was contracted by USAID in June 1996 to provide technical expertise to support capital market development in Ukraine. The original Scope of Work (SOW) designated the SSMSC as FMI’s Ukrainian counterpart, and FMI has worked with the SSMSC since its formal creation. FMI’s Scope of Work, as amended, called for it to accomplish the following:

- (1) Develop the SSMSC’s organizational, administrative, and regulatory capacity
- (2) Improve the legal and regulatory framework of the securities markets with particular focus on
  - a) corporate governance through corporate disclosure in accordance with internationally accepted laws and accounting standards,
  - b) understanding and implementing regulations and instructions already adopted, and
  - c) drafting and gaining Parliamentary approval of new laws and amendments to existing laws governing the capital markets
- (3) Regulating market participants including SROs, securities traders, registrars, custodians, depositories and investment funds, and
- (4) Implementing an active training program for the SSMSC, market participants, issuers, and the general public on all aspects of the securities markets

In addition to assisting the SSMSC, FMI was also tasked with implementing a corporate governance training program for diverse audiences, including corporate issuers, regulators, journalists and judges, and the general public. This financial disclosure and corporate governance education and training component became particularly significant, especially as a result of the numerous and highly publicized

shareholder rights violations cases which have troubled Ukraine's capital markets. The goals of this activity were

- (1) To educate company management on corporate governance best practices and shareholder rights issues,
- (2) To assist in the preparation of annual reports in accordance with internationally accepted accounting standards and
- (3) To help prepare corporate governance issues and forms such as notices of annual general meetings and proxies

At the beginning of the project, the SSMSC was a fledgling organization, with a few Commissioners and a skeletal staff assigned the formidable task of regulating the capital markets. There are now seven full-time Commissioners and a staff of over 550 capable employees in the central and 25 regional offices. The SSMSC today has broad authority over the entire securities markets, including authority to issue regulations, establish public disclosure practices, and sanction market participants for improper conduct. For example, the SSMSC has recognized three organizations as self-regulatory organizations (PFTS - Over the Counter Trading System, PARD - Professional Association of Registrars and Depositories, and UAIB - Ukrainian Association of Investment Business), and continues to increase its knowledge and capacity for overseeing the capital markets.

## **II USAID Objectives**

The main objective of this project was to create a regulatory institution which promotes and fosters transparency, integrity and investor confidence in Ukraine's capital markets. It was important that the SSMSC not only develop an efficient and comprehensive capital markets legal structure, but also develop the market monitoring and enforcement power to enforce the relevant laws and regulations. Also, there was a need to achieve a balance between the objective of ensuring investor protection, while at the same time avoiding the creation of an overly burdensome regulatory environment which might stifle market growth. In this respect, FMI has assisted the SSMSC in drafting regulations which are fair and but not overly restrictive.

The specific task order objectives were

- 1 To fully organize, train, and develop the capital markets supervisory capacity of the SSMSC appropriate to the emerging securities market in Ukraine,
- 2 To stimulate development of a policy, legal and regulatory framework conducive to broad-based, competitive private capital markets growth,
- 3 To provide a comprehensive strategy for creating or improving mechanisms for enforcement of corporate governance standards and shareholders' rights as well as to provide effective training and education for five interested groups (officers and directors of enterprises,

shareholders, investment funds, regulatory authorities, financial journalists and other media),

- 4 To provide coordinated, focused and timely legal and policy advice, and to draft normative acts in close cooperation with the SSMSC,
- 5 To foster licensing and delegation of regulatory authority by the SSMSC to self-regulatory organizations for capital markets in the Ukraine, and
- 6 To enhance the public information campaign related to securities market development and corporate governance

### III FMI Accomplishments

FMI successfully completed all Task Order objectives and met or exceeded all project benchmarks. FMI's accomplishments can be broken down into two main divisions. The first is corporate governance and encompasses corporate disclosure (including reporting in accordance with international accounting standards (IAS)), corporate governance pilots, and corporate governance training. The second is legislative drafting and policy advice, and encompasses the drafting of laws, regulations, instructions, etc. for the securities markets.

#### A Corporate Governance

##### 1 Corporate Disclosure

FMI has assisted the SSMSC in improving financial disclosure by Ukrainian issuers. An important accomplishment was the establishment in October, 1997, of the Public Information Office (PIO) at the SSMSC, which made mandatory issuer filings available to the general public (*See Illustration 1*). This is the first of its kind in the former Soviet Union, and an important first step in the formation of a transparent marketplace. The office, which is similar in concept to the US SEC's Public Reference Room, currently provides information on over 674 Ukrainian companies. Since its opening, the PIO has received more than 4500 market research inquiries, and provided over 2500 copies of PIO materials to researchers.

Equally important is FMI's work in assisting the SSMSC to require issuers to file in accordance with IAS. The Commission has already requested that companies voluntarily do so, and this request has met with overwhelmingly positive responses to comply. The following are some further important accomplishments in this area:

- Methodology for disclosure analysis
- Drafted "Monitoring of Prospectuses Published in October-December 1996"
- Developed detailed instructions for financial disclosure by issuers
- Drafted "Instructions for Completion of Annual Reports" by issuers
- Developed "Methodology for Inspection of Securities Traders"
- Drafted "Accounting Standards and Rules for Custodians"
- Drafted "Methodology for Inspection of Custodians and Depositories"
- Drafted "Disciplinary Code" for SSMSC employees
- Prepared "Guidelines for Record-keeping"
- Drafted "Requirements Specification for the Issuers' Reports Database"
- Prepared 140-page book "A Guide to Preparation of Annual Reports in Ukraine in Accordance with SSMSC Regulations and International Accounting Standards"

In addition to the disclosure methodologies, FMI has also assisted the SSMSC by advising them in their inspections of registrars, issuers, investment companies, trust companies, and securities traders. As *Illustration 2* shows, the SSMSC has significantly increased its inspections and enforcement of market participants.

**COMMISSION PRESS OFFICE NEWS**  
**PUBLIC INFORMATION OFFICE OPENS ON NOVEMBER 12**

On November 12, 1997 the Ukrainian Securities and Stock Market State Commission officially opened a public information office at its central headquarters, located at 51 Gorkova Street in Kiev, Ukraine. The office was made possible through assistance from USAID, and represents a significant step forward for Ukraine in its efforts to create an open and transparent securities market. The office, similar in concept to the public reference room at the US SEC, is the first of its kind in the former Soviet Union. This will be useful for both domestic and foreign investors because it will make it easier for them to obtain information on the largest publicly held companies in Ukraine.

The office currently offers annual and semi-annual reports for approximately 400 of the largest privatized firms in Ukraine. This includes such issuers as Ukrnafta, Ukrnichflot, Azot, Markokhim, NPZ "Galychyna", Lubnypharm, Nyznodneprovsky Truboprokatny Zavod, Naftokhimik, Motor Sich, State Joint Stock Energy Companies, etc. However, because this is the first year in which companies have been required to file their reports, users of the PIO may often find that certain required information is missing. The information required in these reports pursuant to the Commission's "Provisional Regulation on Filing Regular and Special Reports by Open Joint Stock Companies and Issuers of Corporate Bonds" is different from other types of financial reporting, for example reporting for tax purposes. The Regulation requires that issuers disclose their real financial and economic situation for the company as well as their future prospects.

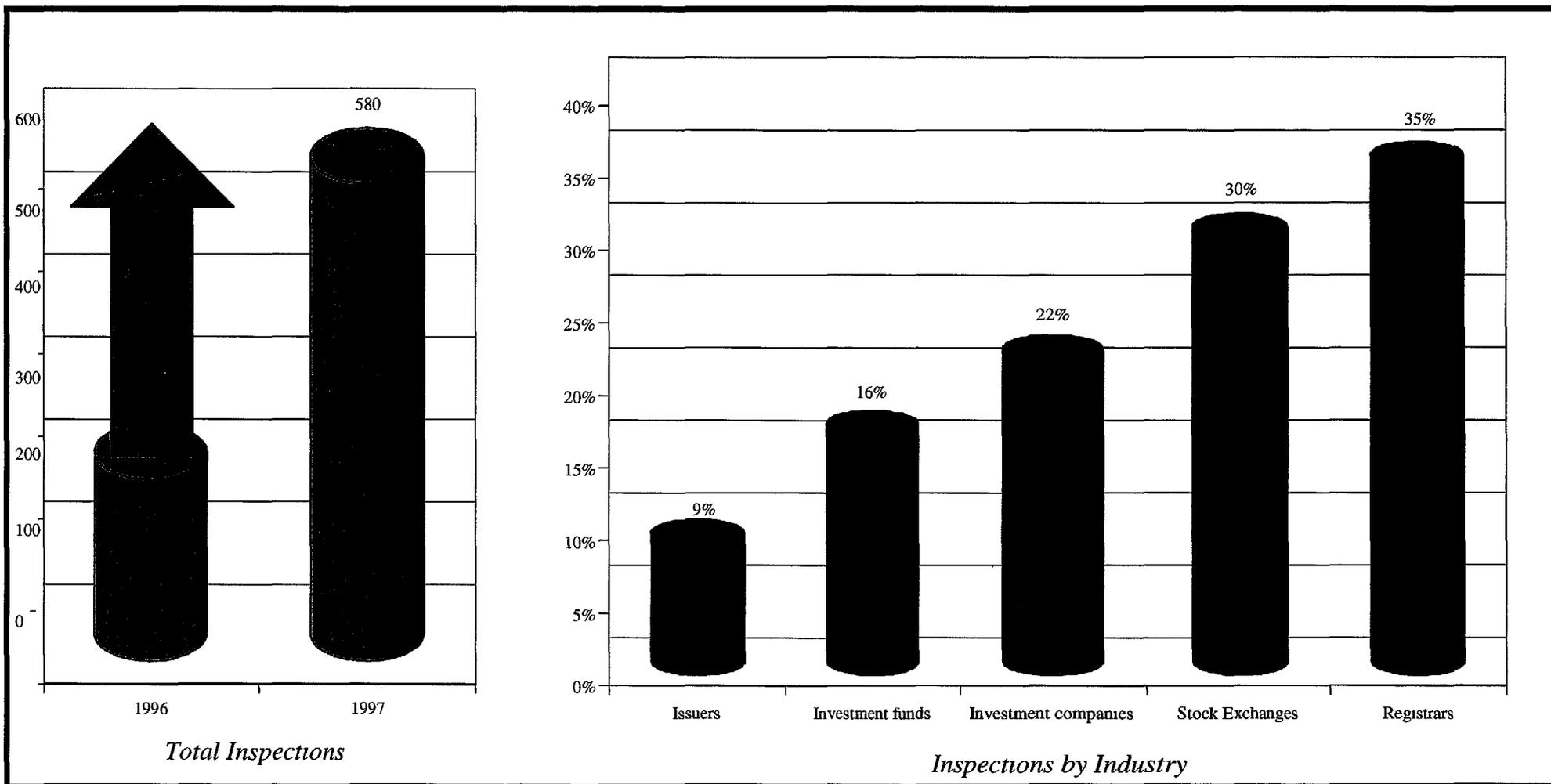
In addition, reports filed with the Commission and available in the Public Information Office should contain a narrative section to provide all the interested parties with more comprehensive information on the company.

The Commission expects to include prospectuses and special reports among the information provided over the next few months. All documents can be viewed without a charge, with a nominal fee charged to receive a copy based on the length of the document.

The company information provided by the office will be categorized by industry and this will also be helpful for general commercial development. Ukrainian firms are currently being encouraged to use their annual reports as a way to advertise their products or services. In this way, the office could be used to bring together purchasers with prospective suppliers.

The Ukrainian Commission expects that the disclosure of information will aid in the development of both the stock market and the Ukrainian economy. The ultimate goal of the office is to provide information on the most actively traded companies in Ukraine to all interested parties. The Commission hopes that the office will be used by potential investors, traders, as well as financial journalists for analysis and comparison of traded companies and assessment of share prices.

**Illustration 1**



**Illustration 2: SSMSC Inspection Activity**

## 2 Corporate Governance Pilots

FMI worked directly with seven companies on a “pilot” basis in order to (1) ensure that at least a few issues would be in compliance with corporate governance “best practices” and IAS, and (2) test methodology for an expansion or “roll-out” phase of this project activity. The following are highlights of the pilot project, and a step-by-step summary of the entire process.

- Selected seven pilots for training
- Conducted two training seminars
- Drafted standard corporate governance forms
- Attended annual shareholders’ meetings to observe for compliance with good corporate governance practices
- Assisted in the preparation of annual reports in accordance with IAS

### a) Criteria for Pilots

The companies either had to be profitable (on a Ministry of Finance accounting basis) or have a good business plan likely to make them profitable. They had to be traded on an exchange or PFTS, or expect to be traded there within the next year. Top management had to commit to best practices with regard to disclosure and corporate governance matters, and had to be willing to provide corporate staff to prepare documents (annual report, notices of annual meetings, protocols for annual meetings, proxies, etc.). Finally, the companies could not have hired a Big Six accounting firm or have plans to do so.

### b) Selection of Pilots

Initially, eight pilot companies were selected to participate in the project. However, three companies failed to submit drafts of their annual reports, and were replaced with two companies which expressed interest in participating in the project. The resulting seven pilot companies remain in the project.

Checkseal -	Textile Manufacturer
Poltavaoblenergo -	Energy Distribution
Svemon -	Telecommunications
Kryvyi Rig Gok -	Ore Refining and Enrichment
Krymenergo -	Electrical Generation
Kyivmetrobud -	Subway Building and Construction
Inhulets Gok -	Ore Refining and Enrichment

The Annual Report Manual prepared by FMI was distributed to all pilot companies, as well as a schedule for the implementation project.

c) Training of Pilots

Training sessions were held in Kiev on December 2, 1997 and March 5, 1998. The December 2 session primarily concentrated on writing annual reports in accordance with IAS, whereas the March 5 session dealt with corporate governance issues, specifically in the areas of shareholders' rights and annual meetings. Representatives from all of the participating pilot companies attended both sessions. Copies of the Annual Report and Corporate Governance Manuals prepared by FMI were distributed to all of the participants.

d) Meetings with Pilots

The pilot companies prepared initial drafts of their annual reports for the 1996 and 1997 fiscal years in accordance with IAS standards. Concurrently, FMI staff consulted with the various companies, answering questions in connection with the preparation of the annual reports. Representatives from the pilot companies visited the offices of FMI on numerous occasions to seek guidance and discuss the various problems encountered by them in converting their financial statements from Ukrainian Statutory Accounting Principles to International Accounting Standards. FMI consultants provided guidance to the company representatives on every occasion, offering comments and suggestions for inclusion in their respective reports. FMI staff performed on-site visits to several of the pilot companies specifically Checkseal, Poltavaoblenergo, Svemon, Kyivmetrobud and Krymenergo. The visits were held in order to meet with the financial directors and other personnel involved in the project and to tour the facilities in order to obtain a thorough understanding of each company's operations. FMI staff also assisted company staff in the preparation of the annual reports during their visits.

e) Annual Meetings

In connection with other corporate governance issues, FMI requested that the pilot companies submit their corporate charters and other corporate governance documents for review and comments in anticipation of their respective annual meetings. Specifically, Checkseal, Poltavaoblenergo, Svemon, Kryvyi Rig Gok and Kyivmetrobud submitted their corporate governance documents. FMI staff completed the legal reviews of the respective corporate charters and other documents, and issued comments and suggestions to ensure such documents were in compliance with all legal requirements.

Checkseal, Svemon, Kryvyi Rig Gok and Kyivmetrobud held their annual shareholders' meetings on various dates on their respective company premises during the term of the project. FMI staff attended all of the above meetings to observe the general conduct of the meetings and found the meetings generally well run and organized, and were designed to allow for the participation by the shareholders. FMI noted that most of the comments and recommendations regarding the corporate governance documents and the annual meetings were adopted.

#### f) Annual Reports

FMI satisfactorily fulfilled its task by assisting at least five pilot companies complete their annual report in accordance with internationally accepted principles by June 30, 1998 (See Appendix 3 for a Sample Report) Moreover, the pilot activity and the methodology developed to implement IAS and corporate governance practices was successful enough to warrant expanding the program to an additional 20 companies in a follow-on Task Order

### 3 Corporate Governance Training

FMI's public education and training component has been a major success One important accomplishment was FMI's assistance to the SSMSC in assembling a high-level corporate governance conference (*See Illustration 3*) This extremely important conference brought together many high-level capital markets officials and professionals, Ukrainian and foreign, to discuss Ukraine's capital markets shortcomings and their possible solutions The conference had excellent, high-level participation and was favorably publicized Among those attending were Deputy Head of the Russian Federal Securities Commission, Valentin Zavanikov, Deputy Secretary of the Polish Security Commission, Miroslav Kachnewski and President of Emerging Value Asset Management, Philip Haas

FMI also conducted corporate governance seminars for SSMSC employees, issuers, arbitration court judges, professors of economy and law, and journalists Effectively employing a variety of media, including radio, press, and television, FMI educated and trained the general public on topics ranging from corporate governance to investing FMI's education and training efforts in capital markets can be divided into educational activities (professional training seminars), preparation of manuals, brochures and other educational materials and media outreach

#### a) Professional Training Seminars

FMI staff provided seminars for five target groups The first target group included market participants, predominantly issuers, but also investment intermediaries Two-day seminars on Corporate Governance, Corporate Disclosure and Shareholder Rights were organized for members of this group in the following Ukrainian cities Kiev (2), Kharkiv, Dnepropetrovsk, Lviv, Uzhgorod, Khmelnytsky, Chernigiv, Poltava, Cherkassy, and Mykolayv (for companies from Kherson, Mykolayv and Kirovograd)

## COMMISSION HOLDS HIGH-LEVEL CORPORATE GOVERNANCE CONFERENCE

On February 26-27, a conference entitled "Prospects for Ukrainian Securities Market Development" was held at the Ukrainian House in Kyiv. The conference was organized by the Securities and Stock Market State Commission in cooperation with ING Barings, Renaissance Capital Group, Wood & Company, Credit Suisse First Boston, Creditanstalt Investment Bank, and FMI/USAID.

This was an extremely important conference, as the goal was to facilitate an exchange among decision makers to address future steps needed to precipitate foreign investment and to develop the securities market in Ukraine. The topics covered at the conference included the role of the stock market in attracting foreign investment, the importance of good corporate governance practices, and the issues involved in the development of a securities market infrastructure.

A variety of international speakers presented their views on the problems and prospects faced in Ukrainian securities markets today, drawing on their experiences in other emerging markets in Central and Eastern Europe and the former Soviet Union. Speakers also included representatives from the Securities and Stock Market State Commission, the National Bank, the Ministry of Finance, and the State Property Fund.

The conference was the result of a decision by the Cabinet of Ministers, and attendees included high-level officials from Parliament, the President's administration, the Cabinet of Ministers, government agencies, and market participants.

**Illustration 3**

More than 1,000 people attended the seminars. Attendees included heads of companies, senior management, and financial officers and accountants. These seminars were not only important for market participants, but were used as a public relations opportunity by the regional Commission offices to introduce themselves to the business community. Press conferences were also held at each seminar and comprehensive media coverage resulted. *See Illustration 4*

The second target group for professional training was professors of economy and law. Educators from every region of Ukraine participated in these seminars. Three-day seminars on corporate finance and shareholders' rights were held for economics professors, in cooperation with the Ukrainian Commercial Business School. In addition, one-day seminars for professors of law were held on legal issues concerning corporate law and shareholder rights. Eight seminars were held in Kiev for over 150 participants. Since academics receive little training in this area in Ukraine, this was a good opportunity to reach this segment of the population, and through the incorporation of materials received in their curricula and courses, to have a wide impact on the student population.

The third target group was arbitration court judges, for whom 3 seminars were held in conjunction with quarterly meetings of arbitration court judges in Kiev. Since many of the issues facing these judges are new, it is important that they learn the issues involved in cases regarding shareholder rights and the securities market in general. Over fifty arbitration court judges from throughout Ukraine participated in these seminars.

The fourth target group was the Commission employees. Their professional training included seminars both in Ukraine and abroad. Ukrainian seminars included

- an enforcement seminar in Kiev,
- a seminar on enforcement and oversight, accounting methodology, organizational structure of regional offices in Guta (western Ukraine),
- a regional office's seminar on corporate governance, enforcement and market infrastructure issues in Sudack (Crimea)

Training abroad included

- Two general securities market training trips to Washington and New York
- Training at the NIS/CEE Enforcement and Market Oversight Training Program, Washington, D. C.
- An IOSCO EMC conference in Johannesburg, South Africa
- Disclosure training in the Washington D. C., USA
- Derivatives training in Chicago, USA
- An IOSCO conference in Taipei, Taiwan
- An accounting conference Belgium, Brussels
- An accounting conference in London, Great Britain
- A price manipulation seminar Warsaw, Poland



Illustration 4: FMI Corporate Governance Seminars in Ukraine

The fifth target group was journalists. While FMI did not provide any specific journalism training on its own, it participated in many training sessions organized by a USAID public education contractor, Gavin Anderson/PBN. FMI personnel also actively participated in the local Press Club's weekly sessions to discuss economic reform in Kiev and the other regions of Ukraine.

b) Manuals and Brochures

The following manuals were prepared:

- Corporate Governance
- Corporate Governance and Shareholders Rights
- General Meeting of Shareholders
- Annual Report Guide

There were also 7 brochures prepared and printed to provide general public background on financial markets, investing, the stock market, and shareholder rights (See Appendix 5). The brochures included:

- If You Become a Shareholder (two different versions, total 3,330,000 copies)
- How to Buy, Sell and Transfer Securities (two different versions, total 2,330,000 copies)
- Securities and Stock Market State Commission ( 50,000 copies)
- Invest Wisely (500,000 copies)
- General Shareholders' Meetings (250,000 copies)
- The Stock Market and Its Participants (printed through "Step by Step" )
- Investment Funds and Companies (250,000 Copies)

In addition, FMI provided regular input on investor rights, corporate governance and the securities market to the Gavin Anderson publications "Privatization Courier," and "Step by Step."

A folder of information on the Commission, market participants, the market infrastructure, and securities laws was also prepared in English, Russian and Ukrainian (10,000 copies), and a special printing of this folder was prepared for the EBRD meetings (1,500 copies). A questionnaire on corporate governance was also designed and mailed to 258 enterprises across Ukraine and an analysis was made of the responses. The questionnaire was later modified and distributed at seminars to be used as input to the new law on joint stock companies.

c) Cooperation with the Media

FMI actively cooperated with both Ukrainian and English language media represented in Kiev on its own and through the USAID public education contractor, Gavin Andersen/PBN. This included comprehensive television and radio coverage devoted to important issues of securities market development and investor rights. The following five minute television infomercials were aired a total of 32 times

- Investment Companies
- Types of Investors
- Why People Buy Securities
- Saving Money
- Ukrainian Stock Exchange
- Securities Market in Ukraine
- Privatization and Post Privatization Process in Ukraine
- Rules for Investors
- "Merry Market" Puppet Show

30 minute radio shows included (aired 33 times)

- The Securities Market in Ukraine
- Securities Market Broker-dealer Activities, Licensing and Regulation of their Activities, Comparison of the Stock Exchanges and OTC Market
- Different Types of Investments and Risks Related to Investments
- Advantages of Trading Securities
- Annual Shareholders' Meetings, Protection of Investors Rights by the Commission
- Advantages of Securities Issuance
- Basics of Trading in Securities and How an Ordinary Citizen Can Buy, Sell and Transfer Securities
- How to Evaluate Securities Yields, How to Make an Investment Decision
- Results, Problems and Prospects of Certificate Auction Centers. The Role of the Registrars
- Discussion of the Law of Ukraine "On State Regulation of Securities Market in Ukraine"
- Annual Shareholders' Meetings, Possible Problems and Prospects
- The Role of the SSMSC, Problems of the Commission with regard to the Protection of Investor Rights
- SROs in the Securities Market
- Electronic Circulation of Securities
- Who are Securities Issuers and Securities Broker-dealers
- Advantages of Foreign Investments and Investments in General
- Advantages of Transparency in the Securities Market
- A Securities Market Review for Ukraine in 1997
- Corporate Governance and State-Owned Shares of Privatized Enterprises Part I
- Corporate Governance Part II

FMI also cooperated with the press and news services. A Reuter's page on the Commission was maintained and Bloomberg was invited to events organized by the Commission. Information was also given to other international news agencies.

newspapers and magazines (Financial Times, Eastern Economist, Wall Street Journal Europe) and broadcast companies (BBC, Svoboda) Local press contacts included the Kyiv Post, Investitsina Gazeta (Investment Newspaper), UFE Review, Dilova Ukraina (Business Ukraine), Uradovy Courier (Government Courier), Posrednick (Intermediary), Galitsky Contracty (Contracts of Galichina), and other daily and weekly newspapers and magazines As previously mentioned FMI also collaborated with regional media to promote Commission activities by holding press-conferences devoted to the activities of the regional offices and corporate governance issues

## **B Legal and Regulatory Framework Development**

As with any new and developing securities market, new laws and regulations are constantly needed, and existing laws and regulations need constant revision FMI assisted the Commission in drafting, amending, and/or providing the Commission with comments regarding, a large number of laws and regulations

In the summer of 1996, when FMI first began its work in Ukraine, the primary legal framework for the securities market consisted of the 1991 Law "On Securities and Stock Market" and the Law "On Business Associations " This legal framework was seriously inadequate as the basis for securities market development For example, there were no provisions designating a primary regulator of the market, nor were there effective limitations on self dealing by managers of investment companies and funds And there were enormous loopholes in the corporate governance and shareholder rights provisions for open joint stock companies Moreover, in the few instances where there were workable legal provisions in the securities law, there was a vacuum of regulation interpreting and giving teeth to the law

As a result, FMI concentrated significant efforts on legislative drafting of the laws which form the legal infrastructure for the securities market in Ukraine Thus, the major pieces of legislation upon which FMI has worked consisted of the Law "On State Regulation of the Securities Market in Ukraine," the Law "On National Depository System and the Electronic Circulation of Securities in Ukraine," the Law "On Securities and Stock Market," the Law "On Investment Companies and Investment Funds," and the Law "On Joint Stock Companies " FMI has made major accomplishments in improving these laws which cover a myriad of issues They establish defined, alienable property rights for securities owners They determine the rules for fair play by individuals and institutions in the securities market They determine what organization will regulate the market and what powers the regulator will have at its disposal They determine the legal requisites for trading in securities and for using market institutions They provide for fair management and for protection of shareholders' rights in joint stock companies And finally, they provide for proper management and regulation of investment companies and funds

The first significant legislative undertaking by FMI was to help legally empower a securities regulator Although the Commission had been formed in 1995 through presidential decree, there was no law that gave it formal authority to regulate the market The Commission was thus unable to regulate securities market participants such as securities traders, issuers and exchanges and trading systems FMI, in

coordination with the US Securities and Exchange Commission, provided comments on the proposed Law "On State Regulation of the Securities Market in Ukraine" and also promoted its adoption along with amendments to the 1991 Law "On Securities and Stock Market". These two pieces of legislation, which were ultimately passed by the Supreme Rada in December of 1996, gave the Commission the legal basis to regulate the securities market and its participants.

Concurrent with the efforts directed at these jurisdictional laws, FMI drafted a series of regulations that could be adopted by the Commission once it formally had the power to regulate. Within a month after the Commission received this power, it adopted all the proposed preliminary regulations that had been prepared by FMI, working in collaboration with the Commissioners. These first regulations, covering diverse matters such as regulation of trading and information systems, periodic reporting by issuers, maintenance of registries and self-regulatory organizations, were the first in a series of regulations which were to be drafted by or commented upon by FMI at the request of the SSMSC during the ensuing two years.

Another major legal infrastructure development effort involved drafting a law that would provide the legal basis for transactions in securities, and that would allow for the development of a depository and a clearance and settlement system in Ukraine. Early in its work in Ukraine, FMI identified legal uncertainty in the clearance and settlement system as a significant impediment to development of the securities market. FMI drafted, provided comments upon, and promoted passage of the Law "On National Depository System and the Electronic Circulation of Securities in Ukraine". Also, concurrent with the work on this law, it drafted 37 separate regulations that would apply to registrars, depositories and other clearance and settlement institutions once the Law came into effect. In December of 1997, this Law was passed by the Supreme Rada, and shortly thereafter, the Commission adopted the underlying regulations.

FMI also undertook a major rewrite of the 1991 Law "On Securities and the Stock Market" to help cure some of the major deficiencies of the current Law. The new version, which is currently awaiting adoption by the Supreme Rada, has a number of enhancements. For example, among other provisions it improves the Commission's ability to regulate by allowing it more flexibility, makes the securities market fairer for small participants through additional special protections, makes several types of improper conduct illegal, and it requires better reporting by issuers. The draft law also would require fairer practices by the buyers and sellers of large blocks of shares, and would add much-needed antifraud provisions making false statements in connection with the sale of a security illegal.

Yet another significant undertaking by FMI was the work on the draft Law "On Investment Companies and Investment Funds". The current regime for investment companies and funds in Ukraine is limited to a few presidential decrees that regulate the subject. The decrees have been widely criticized for failure to establish the proper management structure, incentives and sanctions that would allow for good internal management and effective external regulation. The deficiencies have resulted in inadequate protection of investors rights, and as a consequence, considerable harm has

been done to the market and to investor confidence. FMI responded to these issues and assisted the Commission in both drafting and promoting a new Law which improves management structure and operational requirements for investment companies and funds. The draft Law is now awaiting passage in the Supreme Rada.

The last significant legal infrastructure development work initiated by FMI in 1998 involved the drafting of a Law "On Joint Stock Companies." The existing Law "On Business Associations," has not been effective in protecting the rights of minority shareholders because of large loopholes and inconsistencies that effectively neutralize shareholders' rights provisions. The resulting scandals have gained Ukraine international notoriety for the treatment of foreign investors. FMI took the lead in drafting for the Commission a new Law "On Joint Stock Companies" which, if passed in its current form, would correct many of the problems that have allowed shareholders' rights to be neglected. Most significantly, the proposed draft Law will provide certainty with regard to preemptive rights. It will guarantee shareholder approval for certain large transactions, and it will ensure that purchases and sales of securities, and purchases and sales of company assets, are priced in a manner that prevents dilution or stripping of assets by insiders.

In addition to these major undertakings, FMI also spent considerable time assisting the SSMSC on an *ad hoc* basis as policy or regulatory needs dictated. FMI has remained focused on assisting the SSMSC on matters related to promoting fairness and transparency in the marketplace, as well as protecting investor rights. The following are laws and regulations which FMI has assisted the SSMSC

#### Laws

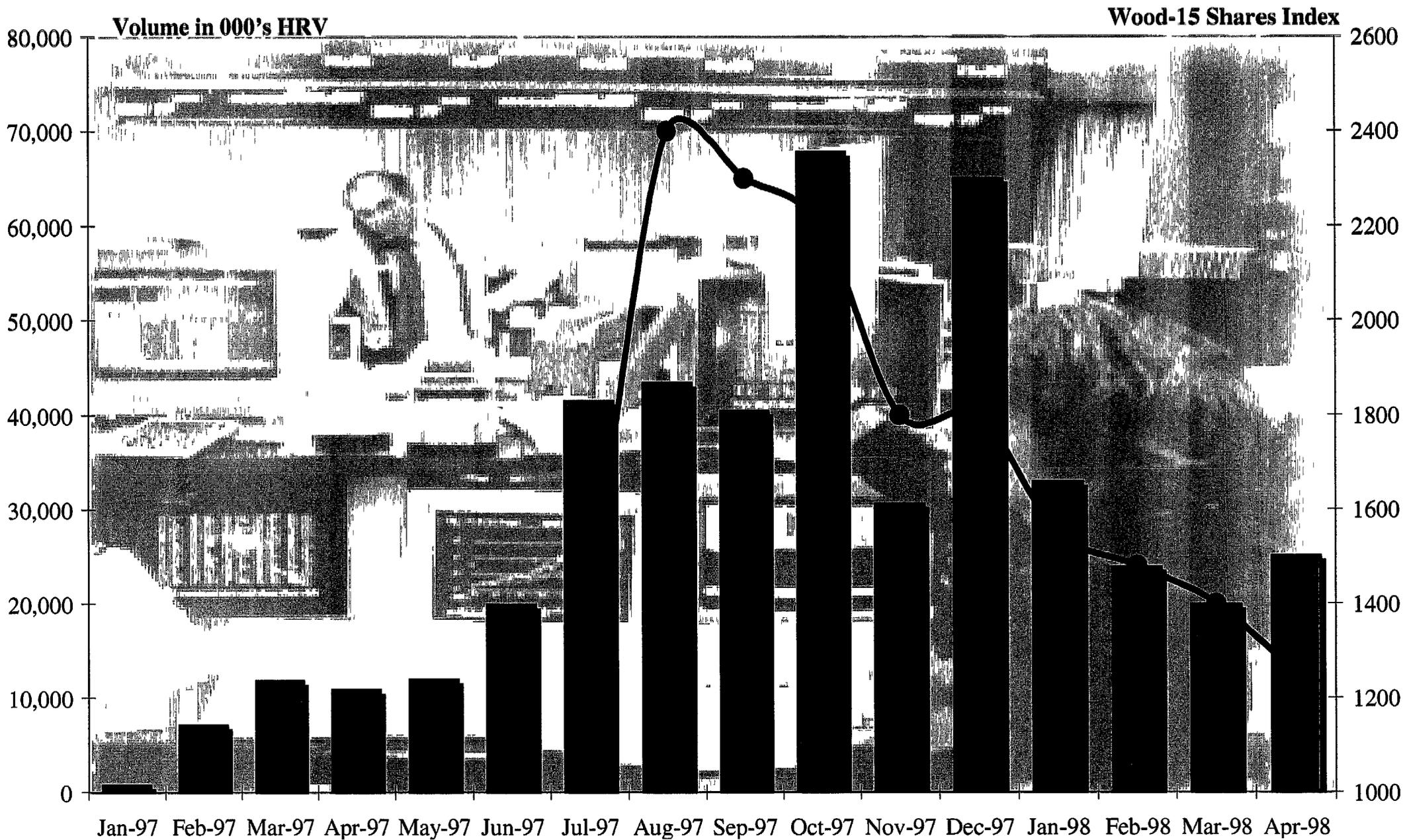
- Law "On State Regulation of the Securities Market in Ukraine"
- Draft law "On Securities and the Stock Market"
- Draft law "On National Depository System and the Electronic Circulation of Securities in Ukraine"
- Draft law "On Joint Investment Institutions"
- Draft law "On Non-Government Pension Funds"
- Draft law "On the Fund for the Protection of Investors"
- Proposed amendments to the law "On Business Associations"
- Proposed amendments to the law "On VAT" and "On Making Amendments to the Law of Ukraine 'On Company Tax'"
- Draft law "On Investment Companies and Investment Funds"
- Draft law "On Collective Investments"
- Draft law "On Joint Stock Companies"

#### Regulations, Instructions, Standards, and Decisions

- Regulation "On Organized OTC Trading and Information Systems"
- Regulation "On Self-Regulatory Organizations in the Securities Markets"
- Regulation "On Filing Regular and Special Reports by Open Joint Stock Companies and Issuers of Corporate Bonds"
- Regulation "On Maintaining the Register of Registered Securities Owners"

- Regulation “On Procedure of Issuing a License on Performing Activity as for Maintaining a Registry”
- Draft Regulation “On Depositories and Depository Activity”
- “Regulation on the Procedure of Registration on the Issuing of Securities and Information on the Issuance”
- Regulation “On Commercial and Commission Activities of Securities Traders with Securities”
- Regulation “On Considering Claims of Individuals by the SSMSC”
- Instruction “On Securities Issuance Coding”
- Instruction “On Statement of Securities Account”
- “Rules for Issue and Circulation of Securities Derivatives”
- Regulation “On the Standard Form and Procedure of Issuing and Circulation of Derivatives”
- Draft Instruction “On procedure of Accepting, Processing, Reviewing, and Registering Documents upon Consideration of Cases of Violation of Applicable Provisions Committed in the Securities Market, Application of Sanctions, and Oversight over Compliance with Sanctions”
- Draft Regulation “On the Order of Admission of Foreign Issuers’ Securities to Circulation in the Territory of Ukraine”
- Draft Regulation “On Advertising Activity in the Securities Market”
- Draft “Procedure for Withdrawal of Documents by the SSMSC”
- Draft Regulation “On Certified Professional Associations”
- Draft Regulation “On Registration of Issue and Information on Issue of Municipal Bonds”
- Draft Regulation “On Unified Depot Account Charts”
- Draft Regulation “On National Depository System Participants Coding”
- Draft Regulation “On Custody Activity”
- Draft “Operational Standards of Securities Accounting in a Custodian”
- Draft “Standard Depository Agreement” (between depository and custodian)
- Draft “Standard Depository Agreement” (between depository and legal entity)
- Draft “Standard Agreement on Servicing Securities Issuance”
- Draft “Standard of Securities Bookkeeping for Custodians”
- Draft “Decision on Combining Professional Activities of a Custodian”
- Draft Instruction “On Issuance and Regulation of Global Certificates”
- Draft Regulation “On Securities Recordkeeping Outside of Ukraine”
- Draft Regulation “On Securities Immobilization”
- Draft Instruction “On National Depository System Participants Coding”
- Draft “Operational Standards of Securities Accounting in a Custodian”
- Draft Decision “On Securities Eligible for the National Depository System”
- Draft Regulation “On Clearance and Settlement in the National Depository System”
- Draft Regulation “On Specific Features of Recordkeeping of Non-Residents’ Ownership Rights to Ukrainian Issuers’ Securities”
- Draft Regulation “On Reorganization Procedure for Closed-end Investment Funds”
- Draft Regulation “On Settlement Bank in the National Depository System”
- Draft Regulation “On Licensing Depository Activity”
- Draft “Sample Agreement on Opening a Securities Account”

- Draft “Sample Depository Agreement”
- Draft “Standards and Rules of Securities Accounting”
- Provision “On Global Certificate of Securities Issued in Book-entry Form”
- Draft “Sample Agreement on Cash Clearing and Settlement”
- Draft “Sample Agreement on Servicing the Securities Issuance”
- Draft “Standards and Rules for Securities Recordkeeping ”
- Draft “Sample Agreement on Opening a Securities Account ”
- Draft “Sample Depository Agreement ”
- Draft “Standards and Rules of Securities Accounting ”
- Provision “On Global Certificate of Securities Issued in Book-entry Form ”
- Draft “Sample Agreement on Cash Clearing and Settlement ”
- Draft “Sample Agreement on Servicing the Securities Issuance ”
- Draft Regulation “On Disclosure of Regular and Special Information by Joint Stock Companies and Credit Securities Issuers”
- Instruction “On the Safekeeping of Securities Certificates”
- Decision “On Regulating the Process of Licensing Individual Types of Professional Activity in the Securities Market and Registration of Securities Issuances”



2

**Illustration 5: PFTS Trading Activity**

#### IV Lessons Learned

USAID made a bold commitment to support the development of Ukraine's capital markets. At the time of the execution of FMI's technical assistance contract in May 1996, there were major policy questions regarding both the legal independence of the Commission and its authority over capital markets. But these questions were resolved satisfactorily, and within a year Ukraine had developed an active over-the-counter market (See Illustration 6).

FMI is proud to have assisted the SSMSC attain its current stature and level of expertise. The SSMSC was at the forefront in making many critical policy decisions in developing the marketplace. Some of these included the interpretation and enforcement of securities laws and regulations, the transition of corporate disclosure into internationally accepted standards, the approval of self-regulatory organizations, and the structure of the depository system.

The SSMSC has performed well, particularly considering the challenging environment in which it operates. However, the growing pains associated with the development of emerging markets present an opportunity to learn important lessons. The following observations are offered for their potential relevance for other securities market development projects.

##### A Strong Project Management is Required to Develop Securities Markets Quickly

Given the highly abbreviated timetable for securities market development in Ukraine, and the myriad players involved in the process, strong, forceful management was critical to success. USAID had to persuade and convince GOU officials of the need to undertake and support actions that frequently were not well understood, had to convince existing and potential market players of the soundness of its advice, and had to demand and get high performance from its contractors. USAID provided strong leadership to the project through Stephen Hadley, Michael Kaiser, Hugh Haworth, and Victor Stetsenko, and gave them considerable latitude in implementing critical policy decisions. Messrs Kaiser, Haworth and Stetsenko worked closely with U.S. Ambassador Morningstar in negotiating an important MOU which helped to resolve numerous impasses.

##### B Long-term Capital Markets Success Requires Developing Institutions with a View Towards Self-sustainability

It will take several more years before Ukraine's capital markets institutions are firmly established. However, two years of intensive in-country activity have facilitated a strong beginning. From the outset of the project, FMI was careful to inform and educate the SSMSC and staff about its role as an adviser, to argue positions on key issues based upon careful analysis not only of capital markets but also Ukrainian realities, and to frame its recommendations consistent with Ukrainian requirements and institutions. Similarly, it was vitally important to train and develop the talents of

FMI's local staff and to give them increasingly visible responsibility for programmatic functions

C Protection of Shareholders' Rights Through Market Surveillance, Inspection, and Enforcement Should Not Be Neglected

In the understandable rush to develop a functioning secondary market quickly, it is important not to overlook market regulation and enforcement. FMI made significant strides in working with the SSMSC in developing regulations and procedures for investigations and enforcement activities, as well as success in training SSMSC staff in market monitoring and inspections. FMI served as an adviser to the SSMSC on several enforcement cases. Under the current legal regime, many problems exist. First, the SSMSC can impose a fine, but only the courts can enforce payment of the fine. Second, potential violators cannot be forced to come in for questioning. Finally, the SSMSC is allowed only 3 days to review and/or copy documents of potential violators for a maximum period of 3 days. FMI recommends that the situation be changed to allow the SSMSC to properly enforce its laws and regulations.

Equally important, FMI is directly involved in implementing a corporate governance MOU signed by U.S. Ambassador Morningstar and Ukrainian Vice Prime Minister Tyhypko. The MOU delineates step-by-step procedures to establish and enforce internationally accepted principles of corporate disclosure and shareholders' rights. Therefore, a major focus of the new technical assistance needs to be the protection of shareholders' rights through implementing internationally accepted corporate governance principles and the enforcement of them.

D Train, Train, Train

There is a seemingly insatiable demand for capital markets training in Ukraine. FMI undertook numerous training initiatives with the SSMSC staff, but training was a never-ending activity. Similarly, FMI's nationwide experience with training seminars for companies on corporate governance and investing revealed a high level of interest in continuing education on capital markets. In FMI's experience, training and education initiatives were most effective when FMI's trained Ukrainian consultants assumed the lead role, buttressed by expatriate expertise as needed. This suggests that a major thrust of future capital markets education and training initiatives should be organized and sponsored by Ukrainian capital markets training institutions, under the tutelage of expatriate expertise.

E In Order to Have Effective Independence and to Fulfill its Mandate to Protect the Investor, the SSMSC Needs Substantially More Funding

The SSMSC currently operates with inadequate office and infrastructure support, and an inadequate budget. The dedication of the Commissioners and staff is all the more remarkable given the conditions under which they work. Either a greater budget allocation from the government or a provision allowing the SSMSC to retain filing fees (not fines) must be approved to provide the SSMSC with the ability to pay increased compensation. This greater SSMSC compensation mechanism would also

benefit the other capital market training institutions by lessening the need of the SSMSC to move towards the area of collecting fees related to testing and licensing natural persons

F Fledgling Enterprises Only Become Mature Institutions Over Time

While a sound beginning has occurred in Ukraine, and the SSMSC has a good legal and regulatory structure to protect and enforce, much still remains to be done. Indeed, an entire follow-on Task Order could be implemented for Ukrainian capital markets to improve identified shortcomings, provide the continuing assistance necessary to train-by-doing, and to institutionalize and sustain appropriate practices of all securities market participants. This includes continuing support to propagate good practices and to monitor and punish the bad ones. The areas of necessary continued support are well known to USAID, and are thoughtfully reflected in a proposed USAID Task Order for capital markets development in Ukraine. Its successful implementation will help solidify a sustained capital markets infrastructure for Ukraine.

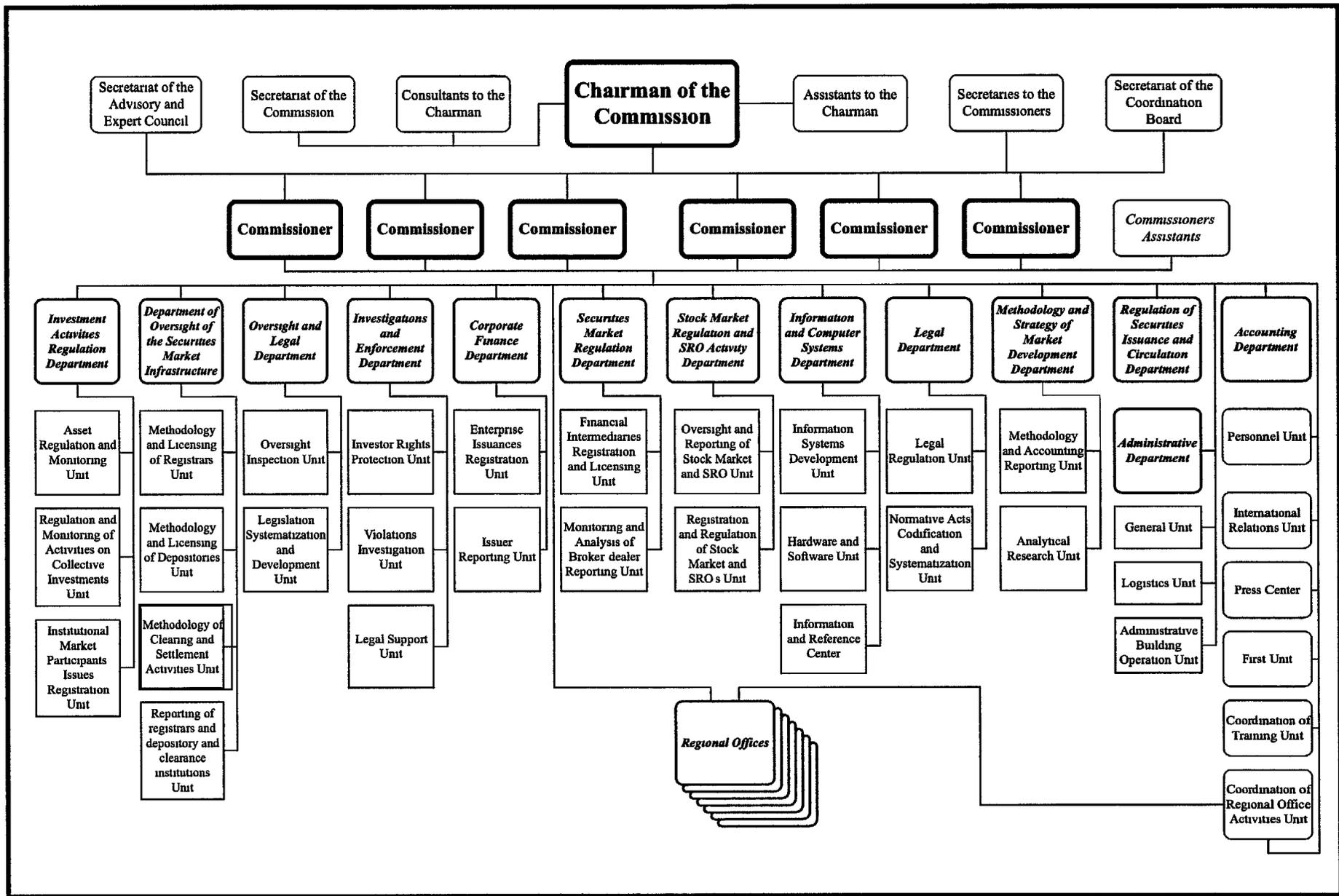


**Financial Markets International, Inc.**

## *Appendices*

- 1 *SSMSC Organizational Chart*
- 2 *US - Ukraine MOU Special Task Force on Corporate Governance and Shareholder Rights*
- 3 *Annual Report of FMI Corporate Governance Pilot Poltavaoblenergo*
- 4 *Sample Brochure Covers on "Invest Wisely," and "General Shareholders' Meetings"*
- 5 *Excerpt from the Brochure entitled "General Shareholders' Meetings"*

*Appendix 1 SSMSC Organizational Chart*



SSMSC Organization Chart

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*Appendix 2 US - Ukraine MOU Special Task Force on Corporate Governance and  
Shareholder Rights*

**Memorandum of Understanding  
on the Special Task Force on Corporate Governance and Shareholder Rights**

The Government of Ukraine (GOU) and the United States Government (USG) hereby affirm their commitment to develop an open, competitive, private-sector based, and well-regulated capital market in Ukraine. Towards that end, the GOU will create a Special Task Force on Corporate Governance and Shareholders' Rights.

The Special Task Force will include participants from the GOU, the US Embassy, donor community, and the private sector. GOU participants will include the Vice Prime Minister for Economic Issues, National Security and Defense Council, the Securities and Stock Exchange State Commission (SSMSC), and the Ministry of Justice. An initial meeting of the Special Task Force will be held on April 9, 1998. An initial set of representatives from the private sector including representatives of the Ukrainian broker-dealer community will be included into the Task Force and modified as appropriate. Participants from the donor community shall be invited to the Task Force including the World Bank, USAID, EU Tacis and the International Finance Corporation. Other appropriate participants may be invited as observers.

The Special Task Force will undertake to

Establish the objectives and an agenda of tasks needed to institute sound corporate governance in Ukraine, to be administered by Ukraine's Securities Commission, that will properly protect shareholder rights and improve the investment climate of the country. It is agreed that the Securities Commission, with the support of its consultants, shall draft the agenda for the consideration of the Task Force.

Set a schedule for achieving the objectives and fulfilling the tasks enunciated above.

Review and comment on specific shareholder cases that indicate problem with the current corporate governance program and advise on practical steps that can be taken to address such cases in a way that is consistent with open, competitive, transparent capital markets.

Advise on legislation and regulation requirements to promote shareholder protections and a healthy investment climate.

Advise on appropriate enforcement mechanisms needed to achieve the corporate governance objectives enunciated by the Task Force.

It is envisaged that through such actions Ukrainian and foreign investors will have greater confidence investing in Ukraine. Thus, shares of Ukrainian companies will trade at higher values in the securities market. Ukrainian companies will be able to more readily raise capital. And, investors will be more willing to buy Ukrainian companies in the Government's

privatization program increasing the revenues to the GOU from these sales

The United States Government is committed to support work of the Task Force through technical assistance to Ukraine's SSMSC provided by Financial Markets International (FMI). In particular, FMI will help the Commission draft a Joint Stock Company Law and develop new corporate governance regulations. The USG will also help the Commission develop a corporate governance program including the implementation of "model" corporate governance pilot projects. The USG will assist the Commission to introduce International Accounting Standards in its corporate disclosure program. Finally, the USG will assist the Commission expand the functionality and capacity of its public information program on shareholder rights.

As the Task Force initiates its work, priority attention will be given to several key legislative and enforcement items. These include:

Adoption by the Securities Commission of regulations, based on current law, which will provide further shareholder protections (e.g., authority to cancel share issuances based on false information, ensuring reorganizations are conducted at fair market value, procedural protections against "squeeze outs")

Passage of the Joint Stock Company Law which will provide comprehensive shareholder rights (e.g., independent appraisals when shareholder disputes occur on share values, protections against insider transactions, shareholder approvals for major transactions, greater authority to the Commission in enforcing corporate governance matters)

Improvement in the Commission's enforcement program including the adoption of anti-fraud provisions and institution of an in-depth training program on enforcement techniques

The Task Force will meet periodically and shall have the authority to submit recommendations to the Presidential Administration, the Cabinet of Ministers, and the SSMSC.

Ambassador Richard Morningstar  
Special Advisor to the President and  
Secretary of State on Assistance to  
the Newly Independent States

Sergei Tyhypko  
Vice Prime Minister of Ukraine on  
Economic Issues

*Appendix 3 Annual Report of FMI Corporate Governance Pilot Poltavaoblenergo*

**THE SECURITIES AND STOCK MARKET STATE COMMISSION  
ISSUERS' REPORT FORM**

**ANNUAL REPORT  
of the State Joint Stock Energy Distributing Company Poltavaoblenergo  
(Name of the Joint Stock Company)  
for 1997**

Enterprise Code 00131819

Name of region Poltava

Registration number in the SSMSC records 01-16-0344/3

### *Introduction*

The State Joint Stock Energy Distributing Company Poltavaoblenergo was established in the form of the open joint stock company through transformation of the state energy distributing enterprise according to the order of the Ministry of Energy and Electrification # 132 dated 07/28/95. At the end of 1996, the Securities and Stock Market State Commission (SSMSC) received the package of documents for receipt of the certificate on registration of initial issue of shares of the Company. The registration took place on January 16, 1997. Statutory fund of the Company consists of 22,096,000 common registered shares at the nominal value UAH 2.5 for the total amount UAH 55,240,000.

Financial reporting of the company was compiled according to the requirements of international accounting standards (IAS).

**Part I**

**1 Main Information on the Issuer**

Name of the Issuer	State Joint Stock Energy Distributing Company Poltvaoblenergo
Enterprise code	00131819
Organizational and legal form	Open joint stock company
# of the certificate on state registration, date of certificate issuance	622r dated 08/23/95
Agency which issued the certificate	Executive Committee of Poltava City Council of People's Deputies
Address	5, Saryj Podil St , Poltava
Telephone	7-18-14
Fax	19-64-24
Teletype	66-43-77 "Set"
E-mail	kanc@pl obl energy gov ua
Settlement account	26006301550017
MFO	331478
Name of the bank	Oktyabske Department of Poltava Prominvestbank
Main types of activities	Transfer and distribution of energy to the consumers
Number of shareholders	-
Number of bond owners	-
Independent registrar	-
Name	-
Address	-
Telephone	-
Securities trader(s) with which an agreement of securities placement has been concluded	-
Name	-
Address	-
Telephone	-
Latest date of publication of information on the issuer's activities	November 18, 1997
Name of the press media	Investytsiyna Gazeta
Circulation	10 2000
Date of filing of the last annual report with the Commission	-
Date of the last annual meeting of shareholders (for open JSCs)	-
Legal entity authorized by the issuer to sell (purchase) its securities in the secondary market	-
Name	-
Address	-
Legal entity authorized by the issuer to pay income on its securities	-
Name	-
Address	-
Date and term of dividends payment if they will be paid	-

Manager's signature \_\_\_\_\_

Date of filing out \_\_\_\_\_

## 2 Information on Received Licenses for Separate Types of Activities and Their Validity Period

All types of activities connected with generation, transfer and distribution of energy in Ukraine should be licensed. All licenses are valid for unlimited period of time. Licenses can be canceled if the National Commission on Energy Regulation in Ukraine (NCER)<sup>1</sup> sends a letter to the license-holder on this 25 years prior to the date of license cancellation. NCER may decide on license cancellation if

- a) the period for which license validity was suspended expired and decision on license suspension was not canceled in the established order,
- b) the license-holder terminated licensed activities on its own initiative in the established order,
- c) the license-holder terminated licensed activities on the basis of the decision of the Anti-Monopoly Committee of Ukraine, court or arbitration court,
- d) activities of the license-holder do not comply with requirements of Ukrainian legislation and
- e) on other reasons specified by the Ukrainian legislation

Poltavaoblenergo JSC holds the following licenses

- License PS # 0024 for the right to carry out entrepreneurial activities on distribution of energy pursuant to regulated tariffs

Territory of the licensed activities — Poltava region and part of Kirovograd region (substation 150/35/6 kV Vlasivka),

- License PR # 0003 for the right to carry out entrepreneurial activities on transfer of energy by local electrical networks

Territory of the licensed activities — Poltava region,

- License VR # 0002 for the right to carry out entrepreneurial activities on energy generation

Type of activities	License # and date of issuance	State agency which issued the license	License validity period
Energy generation	VR # 0002 09/19/96 #2	NCER	Unlimited
Distribution of energy pursuant to regulated tariffs	PS # 0024 09/19/96 #78	NCER	Unlimited
Transfer of energy by local electrical networks	PR # 0003 09/19/96 #32	NCER	Unlimited

Company management believes that cancellation of licenses is practically impossible

<sup>1</sup> NCER issues the licenses for all types of activities connected with energy

### 3 Information on Results of Business Activities for the Reporting Year

During 1997, the volume of Company sales was UAH 216,999,000. The Company incurred UAH 1,325,000 of losses from operating activities and received UAH 9,536,000 income from other activities. Total income of the company after payment of income tax pursuant to the Ukrainian laws was UAH 4,824,000. Losses from operating activities were caused by unbalanced pricing policy of the state represented by the NCER. The difference between average sell and buy prices for electric energy did not cover Company expenses for transfer and distribution of electric energy.

<b>Company activities on sale of electric energy</b>	<b>1996 de facto</b>	<b>1997 de facto</b>
<b>Average buy price for energy (average purchase tariff), kopeck / KW/h</b>	<b>4 46</b>	<b>4 9</b>
Average buy price for energy from independent distributors, kopeck / KW/h	6 12	5 23
Average buy price for energy in the energy market, kopeck / KW/h	2 32	3 78
Average buy price for energy from Kremenchuk HPP, kopeck / KW/h	5 17	5 02
<b>Average sell price for energy (average sale tariff), kopeck / KW/h</b>	<b>6 47</b>	<b>6 82</b>
Payment for energy transit through Company networks, kopeck / KW/h		1 3
<b>Difference, kopeck / KW/h</b>	<b>2 01</b>	<b>1 92</b>
<b>Company expenses for transfer and distribution of energy, kopeck / KW/h</b>	<b>2 89</b>	<b>2 22</b>
Losses of energy in Company networks, kopeck / KW/h	0 82	0 79
Company expenses, kopeck / KW/h	2 07	1 43
<b>Profit (loss) of the Company, kopeck / KW/h</b>	<b>-0 88</b>	<b>-0 30</b>

According to Company prognosis, improvement of this situation is expected in the following years because energy sector will be gradually transforming to market terms of operation. Maybe, in 1998 after elections to the Supreme Council of Ukraine, the Cabinet of Ministers will give its consent to the relevant increase of sale tariffs for electric energy, and this will have a definite positive impact on financial position of the company.

Statement of cash flow shows that total amount of company cash as of the end of 1997 increased by UAH 567,000 because net cash flow from operating activities which was UAH 638,000 exceeded our payments connected with investment activities of the Company (UAH 71,000). Total amount of accounts receivable increased from UAH 22,096,000 to UAH 36,133,000 or by UAH 14,037,000 which is connected with growth of sales in 1997. With UAH 52,306,000 increase of sales, percentage of unpaid energy bills remained without significant changes and is 17% of annual sale volume.

#### Sale

During 1996 and 1997 volume of Company sales was (UAH th )

	1996	1997
Total	164,693 0	216,999
including electric energy	164,121 7	216,378
heating energy	571 3	621

Dynamics of sales volumes was influenced (in the same direction) by three factors

- 1 Increase of energy tariffs (established by the state in Ukraine),
- 2 Increase by 16% of energy consumption by the consumers in the region (KW/h) The main reason for this is appearance of new powerful consumers of electric energy because Kremenchuk HPP began to sell all generated energy to the enterprise Energoynok with transfer to the company of those consumers with which it had agreements on energy distribution previously, and
- 3 Appearance of electric energy transit operations among sales

First factor caused sales volume increase in 1997 by UAH 10,082,000, second factor — UAH 26,412,000, third factor UAH 15,812,000 Total growth was UAH 52,306,000, or 32%

#### Prime Cost

Prime cost of goods sold of the Company consists of expenses directly connected with the production

- expenses for purchase and transfer of electric energy, and
- expenses for generation of heating energy

In total amount of prime cost of goods sold the largest percentage belongs to the value of purchased electric energy These expenses were in 1997 — UAH 177,387,000 or 84%, in 1996 — UAH 143,384 or 88% Increase of expenses for purchase of electric energy in 1997 was caused by growth of its sales to consumers in the region

Expenses for salaries and associated mandatory deductions to government funds (pension fund, employment fund, fund for liquidation of Chernobyl disaster results) in prime cost of goods sold were UAH 12,347,000 (6%) in 1997 and UAH 10,482 (also 6%) in 1996 The reason for total increase of expenses for salaries in 1997 was increase of salaries level according to the orders of the Ministry of Energy of Ukraine The state which was the only owner of the Company represented by the Ministry of Energy took appropriate measures to preserve realistic level of salaries for employees of the energy sector in conditions of Ukrainian inflation economy Taking into consideration difficult financial position and uncovered losses for previous years, payment of bonuses and remunerations to employees in 1997 was significantly reduced

#### Profit from Other Activities

Amount of profit consists of amount of sanctions received from energy consumers and profit of previous years UAH 7 310,000 profit of previous years appeared as a result of

- write-off of accounts payable on deductions to centralized funds as of 12/31/97 according to the new Law of Ukraine "On Taxation of Enterprise's Profit" (UAH 581,500 to innovation funds and UAH 502,500 to labor protection fund),

- write-off of UAH 4,385,000 accounts payable on recalculation of ecological surcharge according to the results of calculation check with the National Dispatch Center of Ukraine for 1996, and
- resettlements with transit electric energy suppliers for the use of Company networks by them in 1996 — UAH 1,841,000

### Information on Main Types of Products of Services Produced or Rendered by Poltavaenergo

Main types of the Company activities are transfer and distribution of electric energy to consumers. The Company is monopolist in transfer of electric energy in Poltava region.

Transfer of Electric Energy, mln KW/h	1996	1997
• Distribution of electric energy (general sale), mln KW/h, per Electrical network Enterprise		
Poltava South Electrical network Enterprise	1,495.2	1,988.7
Poltava East Electrical network Enterprise	559.2	500.7
Lubny Electrical network Enterprise	482.7	457.0
Kremenchuk HPP <sup>2</sup>	307.2	29.3
<b>Poltavaoblenergo (Total)</b>	<b>2,844.3</b>	<b>2,975.7</b>
• Transit of electric energy	1,460.7	1,452.4
<b>Poltavaoblenergo (Total)</b>	<b>4,305.0</b>	<b>4,428.1</b>

General decrease of production volumes in Ukraine caused decrease of electric energy consumption level, which in its turn caused decrease of the volumes of transfer and sale of electric energy by the Company in comparison with previous years. Decrease of electric consumption in the region is caused by general drop in production, first of all, in the industry. Also, some powerful industrial enterprises of the region started to receive electric energy from other commercial distributors. Mostly they are large consumers with pay with their products to independent energy distributor. Loss of several consumers was caused by the fact that the Company is forced to sell electric energy at the tariffs strictly set by the state, while commercial distributors offer cheaper electric energy generated in Russia. In 1997, there was a change in procedure of Company settlements with commercial distributors which conduct transit of electric energy to consumers of Poltava region. Previously, such distributors for utilization of the Company electrical networks, transfer devices and equipment paid with kilowatt-hours of electric energy, and now they pay with cash to settlement account of the Company, promissory notes and offsetting. Company management believes that in modern conditions electric energy transit is more profitable for the JSC because, on the one hand, volume of electric energy purchased by the Company and for which it is necessary to pay partially in cash which insufficient in the Company during non-payment crisis goes down and, on the other hand, the number of insolvent consumers decreases. In total, in 1997, the volume of transits in total volume of electric energy transfer remained on the level of 1996. But already at the end of 1997, the volume of transit deliveries reached 50%. In 1998, increase in transit delivery volumes is expected.

The Company had the following technical indicators

	1996	1997
Release of electric energy to the network	5,107 mln KW/h	5,148 mln KW/h
Losses	790 mln KW/h	712 mln KW/h

<sup>2</sup> From 1997, distribution of electric energy instead of Kremenchuk HPP was conducted by Poltava South Electrical network Enterprise

Percentage in total release of electric energy	15.5%	13.8%
Effective release of electric energy	4,305 mln KW/h	4,428 mln KW/h
Productional needs of the company	12 mln KW/h	8 mln KW/h

Seasonal load schedule influence technical and economic indicators of the company (mln KW/h)

	Average monthly data (1997)	Winter month (January)	Summer month (June)
Losses	59.3 (13.8%)	123.23 (23.27%)	10.77 (3.16%)
Effective release of electric energy	369	405	330

	At the year beginning (January)	Summer month (June)	At the year end (December)
Debts for purchased electric energy (UAH mln)	-699.6	5,270.0	6,149.2
Tariff for purchased electric energy (kopeck / KW/h)	5.6	4.93	4.65

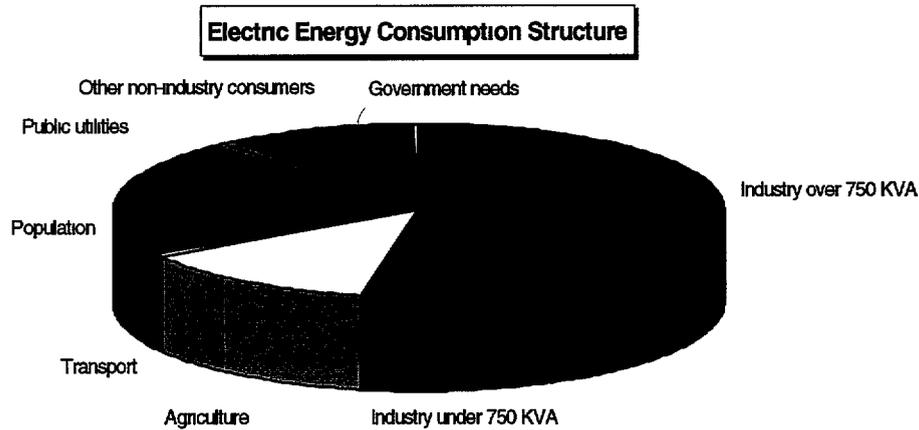
Such fluctuations influence the volume of electric energy purchase due to which, on the one hand, consumption of electric energy increases in winter month and on the other hand, losses of electric energy in the Company networks significantly increase, i.e. prime cost of the goods sold substantially increases in winter months

General Characteristics of the Company	
Total transmission lines, km	49,137
Transformer capacity, MVA	3,907
Distribution area, km <sup>2</sup> th	28.8
Number of employees	3,466
Region population, th	1,753
including Poltava (1989)	315
Land area, hectares	412.9

*Main Consumers of Poltavaoblenergo in 1996  
(percentage to total volume of electric energy distribution)*

	De facto in 1996 (mln KW/h)	%	De facto in 1997 (mln KW/h)	%	Increase (decrease) in % to 1996
Industry under 750 KVA	1,105.0	48.5	1,315.5	52.92	14.19
Industry over 750 KVA	274.1		259.3		
Non-industrial consumers					
Agriculture	489.2	17.2	384.6	12.93	-21.38
Transport	26.8	0.9	26.0	0.87	-2.99
Population	564.2	19.8	639.3	21.48	13.31
Public utilities	58.0	2.0	42.4	1.42	-26.9
Other non-industrial consumers	317.9	11.2	298.9	10.05	-5.98

Business needs of the Company	9 0	0 3	9 6	0 32	6 67
<b>Total efficient consumers</b>	<b>2 844 3</b>	<b>100 0</b>	<b>2,975 6</b>	<b>100 0</b>	<b>4 63</b>



As these data show, market outlet for electric energy of Poltavaoblenergo is diversified. Characteristic feature of industrial sector in Poltava region is existence of solvent enterprises, for example, wheel factory, oil-pipe enterprise, large enterprises of food industry, at the same time there is no chemical industry in the region, and metallurgic industry is practically absent, and they are the worst in Ukraine regarding solvency.

The largest and most important consumer of the Company is Poltava Ore Dressing Plant (ODP) with average energy consumption 117.5 mln KW/h in 1997 compared to 97 mln KW/h in 1996. Relations with this enterprise are very important for the JSC. During 1996, distribution of electric energy to ODP was conducted by Pravex concern which paid for transit of electric energy through Poltavaoblenergo networks with kilowatt-hours. During the first six months of 1997 there was quite difficult situation in the respect of transit deliveries to ODP. Pravex concern stopped transit delivery of electric energy to ODP and new ODP owners had no possibility to arrange quickly transit delivery of electric energy. That is why for several months ODP was consumer of the Company which immediately increased accounts receivable of the JSC. But already from July 1997 transit delivery of electric energy was started by the joint venture BARI which became responsible for payment of ODP debts. Company management considers it completely possible that the debts could be paid next year.

The largest consumers of the Company also are

- Poltava Turbo-Mechanical Plant open JSC,
- Poltava Gas-Discharge Lamp Plant open JSC,
- AvtoKraz open JSC,
- Kremenchuk Steel Plant, and
- Poltavagazprom, enterprise of gas producing complex

Other Types of Activities

The Company renders different services to organizations and natural persons (repair works, link-up to electrical network etc.)

	1996	1997
Profit from sale of services, UAH th	1,741	614

In 1996, the Company managed to achieve significant increase of profit from sale of services due to active search of customers and stimulation of district units of electrical networks to fulfill works (money received for the services remains with the unit for its direct use for own needs and is not transferred to the Company central office)

#### **Functioning of the Energy Sector in Ukraine**

Until April 1996, the Company was independently resolving the issue how to distribute cash revenues from sold electric energy. Due to worsening of situation with payments for electric energy in Ukraine, energy distributing companies tried to pay for purchased electric energy through offsetting leaving cash revenues for their operating activities. In fact, generating companies began to receive not all money for generated energy, while they need this money to pay for fuel and maintain the process of energy generation. To improve this situation, the state represented by the Ministry of Energy suggested to open transit accounts for energy distributing companies in order to centralize distribution of cash revenues from sold electric energy. Calculation of the norm for receipt of cash revenues from transit account was conducted also by the state represented by the Ministry of Energy and Electrification of Ukraine. For Poltavaoblenergo, average norm for receipt of cash revenues was established on the level of 22%, i.e. the Company was receiving for operating activities 22% in the form of cash revenues from the total collection by the Company. This situation lasted till April 1997 — when clearing account started operating.

To form competitive environment in energy sector, The Wholesale Electric Energy Market of Ukraine (WEEM) was established. On November 15, 1996 an agreement between WEEM members was concluded according to which all electric energy generated in Ukraine or imported to Ukraine is sold exclusively through WEEM. Its members are

- 6 generating companies which generate electric energy for electrical networks,
- 27 regional energy distributing companies which purchase electric energy for their regions and sell it to consumers and have obtained the license to carry out entrepreneurial activities on distribution of electric energy according to regulated tariff,
- independent suppliers of electric energy which have obtained the license to carry out entrepreneurial activities on distribution of electric energy according to unregulated tariff, and
- state enterprise Energorynok. Purpose of its activities is intermediation between sell offers of energy generating companies and buy offers of energy distributing companies. Sell offers of energy generating companies and buy offers of energy distributing companies are received by Energorynok company where they are matched.

All payments for electric energy in WEEM are conducted through central bank account — clearing bank account of the wholesale market opened by funds administrator (represented by the state enterprise Energorynok). Clearing bank account of the wholesale market is managed by the market banker (Prominvestbank) on behalf of funds administrator exclusive jurisdiction of which includes definition of what funds and in what proportions will be distributed and transferred to the market participants. Payment for electric energy is received in the clearing bank account and then distributed between all WEEM members according to specially designed algorithm according to which daily for each WEEM member amount of funds due to payment is calculated. For energy distributing companies like Poltavaoblenergo this looks as follows

Daily amount of funds due to payment to energy distributing companies consists of

- funds due to payment for transfer of electric energy (level of payment collection multiplied by accrued amount of payment which is calculated according to NCER tariff for energy transfer),
- funds due to payment for distribution of electric energy (level of payment collection multiplied by accrued amount of payment which is calculated according to NCER tariff for energy distribution), and
- funds due to payment for generation of electric energy (estimated percentage for the market of energy generators multiplied by accrued amount of payment which is calculated according to NCER tariff for HPP electric energy generation, not available for Poltavaoblenergo as Kremenchuk HPP is not a member of WEEM and receives this funds independently)

Daily amount of funds can be decreased in case of extraordinary situations

Main problem for powermen today is, undoubtedly, receiving money for sold electric energy. Over 80% of revenues for electric energy sold in Ukraine are offsets. Average level of cash receipt in the clearing account is between 12 and 15 percent of sold electric energy. The Company occupies the 13<sup>th</sup> place on electric energy consumption in Ukraine but only the 4<sup>th</sup> place on the level of cash revenues from sold electric energy in absolute indices (during the period of clearing account operation — 6.7% of cash revenues from total collection of 26 energy distributing companies of Ukraine, except Kyivenergo) and in the second six months — 2<sup>nd</sup> place (after Kyivenergo) in relative indices.

1997

	April	May	June	July	Aug	Sept	Oct	Nov	Dec
Sale of electric energy UAH th	22 404	27 859	12 732	11 620	13 953	11 678	14 559	13 331	17 689
Cash revenues in clearing account, UAH th	3 905.6	3 385.9	4 458	5 154	3 806	5 079.3	5 154	4 586	6 421
Percentage from sale %	17.4	12.2	35.0	44.3	27.3	43.1	35.4	34.4	36.3
Transfer to the Company account UAH th	753.1	828.9	1 067	1 317	926.7	813.3	638.8	642.2	937.6
Percentage from money collection %	19.2	24.5	24	25.5	24.35	16.01	12.4	14	14.6

Poltavaoblenergo activities are carried out pursuant to Ukrainian legislation on environment protection. No actions of the Company connected with its activities had any significant impact on environment or harmed it. Characteristic feature of this region (Kharkiv, Sumy and Poltava regions) is payment by the consumers (except population) of ecological surcharge which is included in the consumer's account.

#### Company Structure

The Company consists of the following structural subdivisions:

- Poltava South grid,
- Poltava East grid,
- Lubny grid, and
- Kremenchuk heat and power plant

The Poltava South grid (PSG) is actually a basic enterprise of the Company. The majority of the PSG management is a part of the "Poltavaoblenergo" administrative bodies.

The Kremenchuk heat and power plant (HPP) is a Company's structural unit. It has an independent balance, separate settlement account, stamp and seal. Pursuant to the Provision On Kremenchuk HPP the revenues from the principal activity are used by the enterprise independently. The fixed assets value of the Kremenchuk HPP is withdrawn from the composition of the Company's statutory fund pursuant to the Cabinet of Ministers Decree #26/92 as of 12/31/1992 under which the power and heat plants are exempt from the privatization.

Since 1997 the Kremenchuk HPP has terminated the sale of electric power supply to the consumers and forwards the produced power to the wholesale energy market. On July 30 1997 the "National Dispatching Center of Electric Power of Ukraine" (NDC)<sup>3</sup> entered into an agreement with the Poltavaoblenergo on providing the energy produced by the Kremenchuk HPP to the wholesale energy market of Ukraine. The Company took the obligation to deliver the energy to the wholesale energy market (WEM) and NDC took the commitment to receive the energy produced by the Kremenchuk HPP through the delivery points. The payments for the Kremenchuk HPP energy actually delivered to the WEM are made from the clearing (transit) account to the settlement account of the Kremenchuk HPP. The agreement is valid from 08/01/97 till 12/31/97 inclusively. If necessary the term of the agreement could be extended.

At the current moment the Kremenchuk HPP is a subject to consideration whether to lease it or to transfer it into the communal property of Kremenchuk town with its further leaving the Company. Thus, the Company's management considers that the Kremenchuk HPP in no way influenced and shall influence the financial results of the Company. That is why all Company's indicators being part of the financial reporting, are computed without the Kremenchuk HPP data, except 23,600.5 thousand UAH the value of the current and fixed assets of the plant, which were included into the Company's statutory fund during its foundation. During 1996 the State being the sole owner of the Company excluded 5,020.0 thousand UAH of the fixed assets of the Kremenchuk HPP that are exempt from the privatization. Hence, other current assets of the Company include only the amount of 18,580 thousand UAH which indicates the value of the Kremenchuk HPP current assets included into the computation of Company's statutory fund but in fact do not belong to it.

#### **Transformation into the Joint Stock Company**

The "Poltavaoblenergo" Company is in the process of the privatization. The finalized version of the share allocation plan is submitted below.

	% of the statutory fund	Terms
Preferential sale	19.2	11/01/97 - 12/30/97
PPC auction	6.8	11/01/97 - 12/30/97
Cash sale	36	01/01/98 - 09/30/98
Sales at the USE	12	01/01/98 - 06/30/98
State ownership	26	

#### **Capital stock**

<sup>3</sup> NDC provides the routine management of the power distribution within the National power supply system, controls the maintenance of the necessary frequency of the electric power, performs the nodal transfer of energy and regulates the maximum and minimum load.

Issue Registration Certificate Number	23/1/97 as of January 16, 1997
Sources of equity (first part of the liability) as of 12/31/97, in UAH	354,145,000
Statutory fund in UAH	55,240,000
Par value, in UAH	2 5
Number of shares	22,096,000
Type of shares	common
Market value as of 12/31/97 (financial intermediaries buy-up during the preferential sale)	7
Shares availability	19 2%
Market capitalization, in UAH	29,697,024
Capital stock amount according to IAS, UAH	267 716 000
Book value of the share, in UAH	12 12
<i>The shares are expected to be listed on PFTS in June - July 1998</i>	

### **Company Development Prospects**

Given the Law On Electric Energy, passed on 10/16/97, and Law On Taxation of the Enterprises, passed on 05/22/97, expected are material changes to maintaining records of the power distribution. It will undergo considerable changes. The volume of power sales shall be determined according to the actual power distribution but not according to the accrued receipts of payments. In particular it is related to the individual consumers. To calculate the actual amount of distributed energy, the Company shall enter into an agreement with every physical person on annual level of power consumption and amount of monthly payment to due (as well as the volume of power consumption). Pursuant to these agreements the total amount of power consumption per capita and population in general should be determined. Upon the implementation of the settlement accounting system, every consumer shall receive the monthly bill. It will help the Company to control the monthly debt amount pursuant to the concluded agreements which will be proven by the actual indebtedness on the basis of the accounting data entered to the consumer's personal account by the Company's officer. The entry will be made not less than once in a year. The computerized version of the indicated system shall be introduced in the first quarter of 1998 in Zinkiv rayon grid which is a structural subdivision of the Company.

The program is expected to last for 2 - 3 years. Its cost depends on the financing sources. The implementation of the new system for power supply accounting and settlements shall require 100% computerization, replacement of the initial accounting tools and tools that provide the data collection. (At the first rate it will be implemented in Poltava and Kremenchuk, the places with the highest level of population). In connection with these innovations the retraining and upgrading programs shall be offered for a part of blue and white collar workers of the Company.

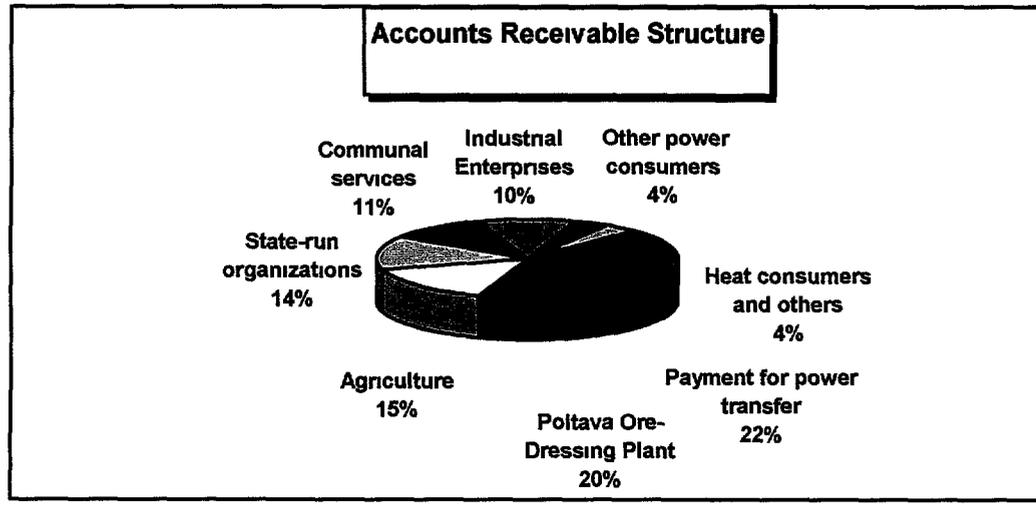
The implementation of this system (technical support in particular) shall require significant amount of funds. The Company's management plans to attract a portion of funds earned from share sale after the strategic investor exercises the commercial tender conditions. 36% share package (19,886,400 UAH for par value) is offered for the commercial tender which is to take place on September 30, 1998. The tentative amount of funds to be set forth by the tender is 116 mln UAH, e.g. these are moneys that the strategic investor - the tender winner - should invest into the Company's development within three years. The implementation of this system shall help the company to reduce significantly the technological losses in the grids.

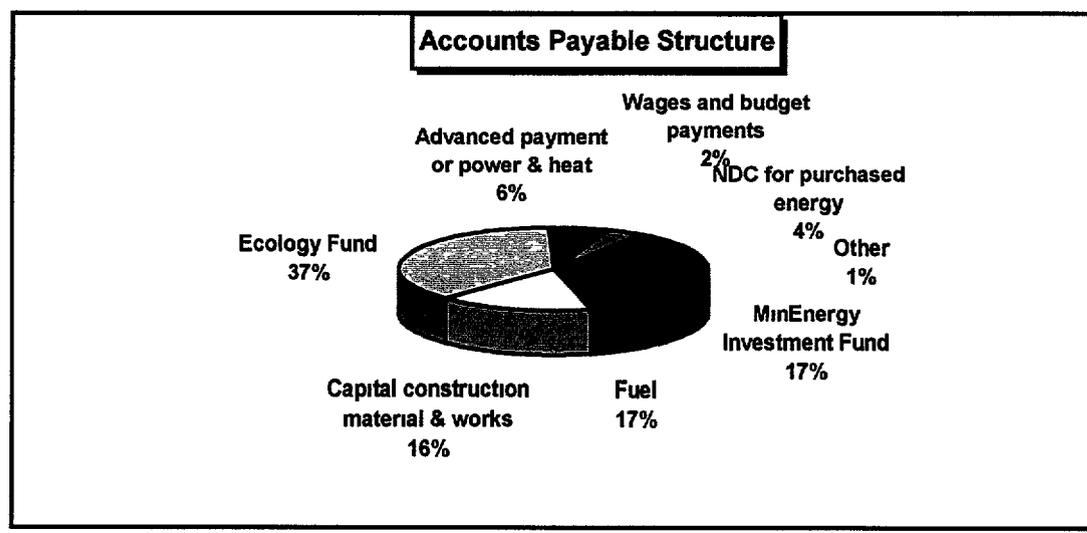
(especially commercial losses, or stealing of the energy), which will drastically cut down the prime cost of the sold product due to material cutback of the power volume which was not paid for

**4 Statement of Financial Position**

**Accounts Receivable and Accounts Payable**

<i>Accounts Receivable</i>		<i>Accounts Payable</i>	
Payment for power transfer	8177	NDC for purchased energy	6149
Poltava ore-dressing plant	7241	Fuel	6039
Agriculture	5552	Capital construction material & works	5846
Budgeted enterprises	4924	Ecology fund	13580
Communal services	3799	Advanced payment for power & heat	2240
Industrial enterprises	3721	MinEnergy Investment fund	1390
Other power consumers	1412	Wages and budget payments	734
Heat consumers and others	1307	Other	344
<b>Total accounts receivable</b>	<b>36133</b>	<b>Total accounts payable</b>	<b>36322</b>





### Statutory Fund

In early 1996 the Company's statutory fund was equal to 60,260 thousand UAH Pursuant to the Property Value Assessment Act, during the privatization period and while estimating the statutory fund included 36,659 5 thousand UAH of the fixed and current assets of the grids plus 18,580 5 thousand UAH of the current assets, plus 5,020 thousand UAH of the fixed assets of the Kremenchuk HPP (The majority of the Kremenchuk HPP fixed assets were not included during the computation of the Company's statutory fund pursuant to the Cabinet of Ministers Decree #26/72 as of 12/31/1992, which exempts the heat and power plants from the privatization) In 1996 the State being the single owner of the Company passed the decision on decreasing the Company's statutory fund through withdrawal of the Kremenchuk HPP fixed assets from the fund On November 22, 1996 pursuant to the joint order of the State Property Fund for Ukraine (SPF) and Ministry of Energy and Electrification of Ukraine (MEE) the Company's statutory fund was reduced to 55,240 thousand UAH In accordance with the further withdrawal of the Kremenchuk HPP from the Company's composition with all fixed and current assets belonging to the plant, the Company's management considers it necessary to include into the Company's "other current assets" category the amount of 18,580 thousand UAH that indicates the value of Kremenchuk HPP current assets included into the Company's statutory fund, however these current assets actually do not belong to the Company These assets will be long to the indicated category until the final solution about the Kremenchuk HPP is made

### Grid Characteristics

Total length of power lines in km	49,048 (01/01/97)	49,137 (01/01/98)
Length of the hanged power lines	47,378	47,463
incl with voltage of 154 kV	508	508
110 kV	1,824	1,824
35 kV	2,507	2,607
10 kV	17,449	17,459
6 kV	362	360
0.4 kV	24,628	24,705
Length of the grids' cable lines in km	1,670	1,674

6 kV	446	441
0.4 kV	652	653
Number of step-down transformer substations 35 - 750 kV and power transformer output (item/MVA)	205/2,251.7	205/2,251.7
<b>Regarding the power lines length the Company is the fifth largest enterprise</b>		

***Characteristics of the Fixed Assets***

Name of the fixed assets	Owned fixed assets, th UAH		Leased fixed assets, th UAH	
	For period beginning	For period end	For period beginning	For period end
1 Production assets	470,715	476,241		
buildings, structures, machines	26,483	29,043		
and equipment, transmitting	71,147	70,274		
terminal	367,066	369,332		
others	6,019			
2 Non-production assets				
buildings, structures, machines				
and equipment, others				
The depreciation of the production fixed assets as of 12/31/97 makes 50% from the historical value				

In 1997 the Company calculates the depreciation index by the method of balance double reduction. The depreciation norms for the fixed assets are:

- Buildings and structures - 5%,
- Transmitting terminal - 5%,
- Machines and equipment - 15%

To calculate the prime cost of the products sold the Company applies the method which sets forth concrete elements of inventories actually used.

**5 Information on the Issuer's Securities**

a) Information on all securities issues (including the securities issued in the reporting period)

Registration certificate number for the first issue Date of certificate issue	Registration Certificate for the first securities issue of "Poltavaoblenergo" Company # 01-16/3 as of January 16, 1997			
Type of share	Par value, in UAH	Amount	Total par value of issue	Percentage from the total amount of statutory fund
Common (registered or bearer)	2.5	22,096,000	55,240,000	100%
Preferential (registered or bearer)	-	-	-	-

b) Information about persons that own over 5% of the issuer's shares

Name of legal entity or natural person	Type of share	Number of shares owned	Percentage for the total number of shares

State in person of Ministry of Energy of Ukraine	common	100%	100%
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**6 "Enterprise Balance Sheet" and "Statement on Financial Results and their utilization" for the reporting period**

**ENTERPRISE BALANCE SHEET**  
(consolidated report, Kremenchuk HHP assets included)  
(in thousand UAH)

ASSETS	Line Code	as of 1997 beginning	as of 1997 end
1	2	3	4
<b>I Fixed and other long term assets</b>			
Fixed assets			
Residual value	010	296,759	284,752
depreciation *(02)	011	294,828	313,764
historical cost *(01)	012	591,587	598,516
Intangible assets			
residual value	020	4	20
amortization *(02)	021	-	10
historical cost *(01)	022	4	30
Capital investments in process (33 35,61)	030	42,119	41,952
Technological equipment (07)	035	2,659	2,505
Long-term financial investments (58)	040	0	0
Settlements with founders (75)	050	0	0
Rented property (11)	055	0	0
Other long-term assets	060	384	144
<b>Total for Section 1</b>	<b>070</b>	<b>341,925</b>	<b>329,373</b>
<b>2 Stocks and expenditures</b>			
Industrial stocks (05, 06 08, 10)	080	6 871	7,459
Livestock for raising & fattening (09)	090	4	7
Low-value and short-term items			
residual value	100	1,115	1,323
depreciation *(13)	101	670	707
historical cost *(12)	102	1,785	2,030
goods in process (20,21,23,29 30,36,43 44)	110	196	-
-----	111		
Deferred expenses (031)	120	0	2
Ready-made products (40)	130	0	0
Goods			
selling cost (41)	140	6	15
sales margin *(42)	141	0	0
cost of sales *(41)	142	6	15
<b>Total for Section 2</b>	<b>150</b>	<b>8,192</b>	<b>8,806</b>
<b>3 Cash, settlements and other assets</b>			
Shipped goods payment for which is not yet due (45)	160	-	31,464
Settlements with debtors			
for goods, works and services not yet due (62, 76)	170	16 166	20,142
overdue	180	35,538	25,521
for notes receivable (59)	190	0	0
for tax settlements	195	0	2,451



Short - term bank loans (90)	600	0	0
Short - term debt (95)	610	0	0
Short - term credits and loans overdue	620	0	0
Settlements with creditors			
for goods, works and services not yet due	640	37 073	43,357
on notes payable (66)	650	0	0
for advances received (61)	660	9,651	2,313
on taxation settlements (67)	665	481	3,006
with budget (68)	670	0	2,333
on non - budgetary payments (65)	680	619	480
on insurance (89)	690	756	311
on salaries (70)	700	1,568	649
with trust entities (78)	710	956	1,390
with other creditors (71, 76)	720	50	58
Loans to employees (97)	730	23	66
Other short - term liabilities	740	0	0
<b>Total for Section 3</b>	<b>750</b>	<b>59,699</b>	<b>67,481</b>
<b>BALANCE (sum of lines 495, 530, 750)</b>	<b>760</b>	<b>409,184</b>	<b>421,626</b>

#### NOTES

Index name	Line code	Balance at the year beginning	For reporting 1997 period		Balance at the end of the reporting year
			accrued (created, earned)	utilized (transfer red)	
Spent for financing the capital and other investments from the year beginning					
depreciation of the fixed assets	900	63	17,667	5,428	12 302
amortization of the intangible assets	905	0	10	10	0
profit directed to the development and improvement of the production and social sphere	910	0	5	5	0
budget and extra-budget funds	920	0	0	0	0
other attracted funds	930	0	185	152	33
Total (lines 900 - 930)	940	63	17,867	5,595	12 335
Cash flow in national currency units, total	945	608	16,612	16,092	1 128
in connection with production	946	X	16,197	15,810	X
Cash flow in foreign currency	950	0	0	0	0
in connection with production and sales	951	X	0	0	0
Internal liabilities					
Receivables (lines 160 - 240, form 1)	960	58,393	X	X	82,300
Payables (lines 630 - 720, form 1)	970	59,676	X	X	67 150
Reversed financial assistance, expired	980	0	0	0	0
Commercial loan	985	0	0	0	0
Budget loan for purchasing agricultural products, expired	990	0	0	0	0
Advance payment for the account of the budget loan, expired	995	0	0	0	0

## REPORT ON FINANCIAL RESULTS AND THEIR UTILIZATION

### 1 FINANCIAL RESULTS

Index name	Line code	Profits	Losses
1	2	3	4
Revenue (gross income) raised from sale of products (goods, works, services)	010	320 214	X
State price regulation	011		X
Value added tax	015	X	12,969
Excise taxes	020	X	0
	025	X	0
	030	X	0
Cost of products (works, services)	040	X	300,616
Results of sales	050	6,629	0
Results of other sales	060	898	0
Corporate rights ownership returns	070	0	X
Retained interest	080	0	X
Other non-sales profits and losses	085	12,371	0
Total profits and losses	090	19,898	0
Balance sheet profit or loss	100	19,898	0
Income tax	105	X	6,432
Other use of profit	110	X	13,466
Retained earning (bad losses) for the reporting period	120	0	0

### 2 UTILIZATION OF PROFIT

Index name	Line code	End of 1997
1	2	3
Payments to the budget	200	7,009
Allocation to reserve (insurance) fund	210	0
Allocated to		
production development	220	4,011
social development	230	1,735
incentive purposes	240	937
dividends	245	0
proceeds withdrawal	250	0
replenishment of the current assets	255	0
other purposes	260	6,206

### 3 PRODUCTION EXPENSE (TURNOVER EXPENSE)

Index	Row code	Total
1	2	3
Supply expense	300	71431
Wages expense	310	13365
Social expense	320	6593
Depreciation	330	17677
Other expense	340	171197

Total	350	280263
Actual production volume (products, services)	360	122684

#### 4 BREAKDOWN BY PROFIT AND LOSS

Index	Row code	Profit	Loss
1	2	3	4
Profit (loss) over the past years	400	0	0
Fines, penalties, forfeit	410	X	0
Financial results of			
force majeure	420	X	0
writing off debts with expired limitation	430	0	0
surcharges	440	0	X
writing off unpaid payments	450	0	X
fluctuations of foreign currency rates	460	0	0
liquidation of capital assets	465	2	0
joint activity	470	0	0
selling of capital assets, intangibles, inventories	480	806	0
selling of securities	490	0	0
letting of separate property	495	92	0
buying and selling foreign currency	500	0	0
	510	0	0

#### 5 PAYMENTS TO THE BUDGET

Index	Row code	Payment due	Actually paid
1	2	3	4
Excise duty	600	0	0
VAT	610	5602	3742
Chernobyl Fund	620	1596	1636
Rent	630	0	0
Resource payments	640	620	546
Other taxes and payments	650	9142	8301

## 7 Information About the Issuer's Executives

Full name	Age	Position	Education	Executive experience (companies and positions)
Boris Popov	50	Chairman of the Board-Director	Higher	<u>15 years</u> since 1982 - Kharkivenergo, Chief Engineer since 1994 - Kharkivenergo, Director since 1995 - Poltavaoblenergo, Chairman of the Board, Director
Anatoly Shalakhman	60	Deputy Director for general issues	Higher	<u>27 years</u> since 1970 - Kharkivenergo, Deputy Production Manager since 1970 - Kharkivenergo, Capital Construction Manager since 1979 - Kharkivenergo, Deputy Director for general issues since 1995 - Poltavaoblenergo, Deputy Director for general issues
Volodymyr Yartsev	50	Chief Engineer	Higher	<u>21 years</u> since 1976 - Poltava MK-76, Production Manager since 1982 - Poltava MK-76, Chief Engineer since 1986 - Poltava MK-767, Senior Engineer since 1992 - Kharkivenergo, High Voltage Power Transmission Supervisor since 1994 - Kharkivenergo, Chief Engineer since 1995 - Poltavaoblenergo, Chief Engineer
Mykola Kantoka	61	Deputy Director for personnel	Higher	<u>19 years</u> since 1978 - Ukrdniprogeolbud Research Institute, Deputy Electrotechnical Manager since 1994 - zKharkivenergo, Deputy Director for personnel since 1995 - Poltavaoblenergo, Deputy Director for personnel
Olexandr Raketsky	40	Deputy Director for labor safety	Higher	<u>14 years</u> since 1983 - Kharkivenergo,

				<p>Foreman since 1986 - Kharkivenergo, High Voltage Power Transmission Manager since 1994 - Kharkivenergo, Deputy Director for safety labor since 1995 - Poltavaoblenergo, Deputy Director for safety labor</p>
Ivan Borodai	51	deputy Director for economics	Higher	<p><u>25 years</u> since 1972 - Poltava High Power Transmission, Foreman since 1973 - Poltava High Power Transmission, Energy Sales Manager since 1973 - Kharkivenergo, Regional Team Leader since 1975 - Kharkivenergo, Regional Subsidiary Deputy Head since 1976 - Kharkivenergo, Regional Subsidiary Chief Engineer since 1987 - Kharkivenergo, Deputy Chief Engineer since 1989 - Kharkivenergo, Deputy Director for commerce since 1995 - Poltavaoblenergo, Deputy Director for economics</p>
Stanislav Stegny	50	Chief Accountant	Higher	<p><u>15 years</u> since 1982 - Kharkivenergo, Chief Accountant since 1983 - Poltava Mechanical Plant, Deputy IT Manager since 1985 - Poltava Mechanical Plant, Financial and Sales Manager since 1991 - Poltava Mechanical Plant, Deputy Chief Accountant since 1991 - Kharkivenergo, Chief Accountant since 1995 - Kharkivenergo, Deputy Director for economics and energy consumption since 1996 - Poltavaoblenergo, Chief Accountant</p>

## 8 Information Published by the Issuer in Press

Name of the issuer	Poltavaoblenergo
State registration code	00131819
State registration certificate, No and date of issue	6228 of 23 08 95
Location	314022, Poltava, Staryi Podil St 5
Telephone	7-18-14
Fax	19-64-24
Core types of activity	Energy transmission and supply
Number of shareholders	-
Number of bond holders	-
Number of employees	4269
Statutory Fund	55 240 000
- common shares (amount and share in the Statutory Fund)	22 096 000 (100%)
- preferred shares (amount and share in the Statutory Fund)	- -
Date of the most recent shareholders' meeting (for open JSC)	-
Name and location of the legal entity authorized by the issuer to sell or purchase securities of the issuer	-
Name and location of the legal entity authorized by the issuer to pay dividends on securities of the issuer	-
Date and period of payment of dividends if at all	-

## 9 Key Financial Indices

Index	Year	
	previous (1996)	reported (1997)
1 Gross margin generated from sales, works, services less state price regulation, VAT and excise duty, th UAH	164 693	216 999
2 Balance-sheet profit (loss), th UAH	(3508,1)	4 824
3 Total assets, th UAH	296485,6	304 038
4 Total liabilities, th UAH	35 222,5	36 322
5 Statutory Fund, UAH (for reference share par value, UAH)	55 240 000 2,5	55 240 000 2,5
6 Retained earnings (loss)	(4568 3)	256
7 Earnings per common share	-	0,22
8 Dividends per common share	-	-

**Part II**  
**Report on Financial Position of Poltavaoblenergo**

th UAH

	<i>Assets</i>	Previous period as of 31 12 1996	Reported period as of 31 12 1997
1	Monetary items	550	250
1a	Monetary items in transit (Note 2)	0	867
2	Short-term financial investments	0	0
3	Accounts receivable for products, works, services, net (including doubtful debts) (Note 3)	22096	36133
4	Other accounts receivable (Note 4)	22	3999
5	Inventory (Note 5)	2557	3307
6	Other circulating assets (Note 6)	3053	1365
	<b>Total current assets</b>	<b>28278</b>	<b>45921</b>
7	Fixed assets (Note 7)		
	primary cost	473865	479497
	depreciation	224241	239981
	residual cost	249624	239516
8	Intangible assets (Note 8)		
	primary cost	4	30
	amortization	1	10
	residual cost	3	20
9	Long-term investments	0	0
10	Other long-term assets	0	0
	<b>Total non-circulating assets</b>	<b>249627</b>	<b>239536</b>
11	Assets of Kremenchuk HPP included in the Company's Statutory Fund (Note 9)	18581	18581
	<b>Balance</b>	<b>296486</b>	<b>304038</b>
	<b>Liabilities and own capital</b>		
12	Short-term bank loans	0	0
13	Liabilities of short-term loan instruments	0	0
14	Accounts payable (Note 10)	2268	18053
15	Current payments under long-term liabilities	0	0
16	Other short-term liabilities (Note 11)	32955	18269
	<b>Total current liabilities</b>	<b>35223</b>	<b>36322</b>
17	Long-term bank loans	0	0

	1996	1997
Item		
1 Sales (Note 14)	164693	216999
2 Cost of goods sold (Note 15)	162483	212086
3 Gross margin	2210	4913
4 Operating expenses		
- administrative costs (Note 16)	1171	1507
- sales costs (Note 17)	3880	4234
- planning and research costs	0	17
- other expenses (Note 18)	938	480
Total operating expenses	5989	6238
5 Profit (loss) from operating activity	(379)	(1325)
6 Profit (loss) from other activities		
- profit (loss) from other sales (Note 19)	1741	614
- dividends received	0	0
- interest received	0	0
- interest paid	123	0
- other profit (loss) (Note 20)	510	8922
Total profit from other activities	2128	9641
7 Profit (loss) from core activity	(1651)	8211
8 Pretax profit	(2003)	7829
9 Profits tax (Note 22)	1505	3005
10 Extraordinary items (Note 21)	(352)	(382)
11 Net profit (loss)	(3508)	4824
- dividends,	0	0
- retained earnings (loss)	(3508)	4824
Net profit per common share	-	0 22
Annual average number of common shares (Note 23)	-	22 096 000

th UAH

Profit and Loss Statement of Poltavoblenergo  
for the year ended December 31

	1996	1997
18 Liabilities of long-term loan instruments	0	0
19 Other long-term instruments	0	0
Total long-term instruments	0	0
Total liabilities	35223	36322
20 Statutory Fund (Note 12)	55240	55240
21 Additional Capital (Note 13)	2947	3848
22 Retained earnings (losses)	(4568)	256
23 Indentation	207644	208372
Total own capital	261263	267716
Balance	296486	304038

#	Retained profit (loss) at the beginning of the year	(1060)	(4568)
#	Retained profit (loss) at the end of the year	(4568)	256

**Cash Flow Statement of Poltavaoblenergo**  
for 1997

th UAH

1	Cash flow from operating activity	
	Net profit (loss)	4824
	Amortization	15566
	Accrued extraordinary profit not related to receipts	(91)
	Increase in accounts receivable	(13886)
	Increase in accounts payable	15786
	Increase in inventories	(751)
	Other increases in cash flows resulting from operating activities	(20788)
	Profit (loss) from sales of securities	0
	Profit from sales of fixed assets	(22)
	"Net" cash flow from operating activity	638
2	Cash flow from investments	
	Purchase of non-circulating assets	(71)
	Payments related to construction, assembly, and adjustment of non-circulating assets - payments to subcontractors	0
	Sales of non-circulating assets	0
	Purchase of assets ascribed to short-term financial investments	0
	Sales of assets ascribed to short-term financial investments	0
	"Net" cash flow from investments	(71)
3	Cash flow from financial operations	
	Issuance of securities	0
	Borrowed money	0
	Redemption of liabilities	0
	Payment of dividends	0
	"Net" cash flow from financial operations	0
	<b>Total "net" cash flow</b>	<b>567</b>
	Monetary items at the beginning of year - 01 01 1997	550

## Notes to Financial Reporting by Poltavaoblenergo in 1997

### Note 1

The Poltavaoblenergo State Joint Stock Energy Distribution Company (hereinafter as the Company) was founded as an open joint stock company through restructuring the former state-run energy distribution enterprise following the order issued by the Ministry of Energy and Electrification of 28 07 1995

The Company is primarily engaged in the energy distribution and supply to consumers of Poltava Region. The Company also offers its power lines for the energy traffic and produces and supplies small volumes of heat (20-25 thousands of gCal as the year average)

Financial reporting of the Company includes

- Report on financial position
- Profit and loss statement
- Cash flow statement

Financial reporting covers the period of 1 01 1997 through 31 12 1997 and is expressed in UAH as the national currency of Ukraine

### Note 2 Monetary Items in Transit

According to the currently effective settlement procedure, energy suppliers accumulate all payments from their consumers on a transit account from which all the payments are immediately and fully transferred to the clearing account of the funds manager - the Energorynok which is exclusively responsible for distribution of funds among WEEM members. The funds returned to the energy supplier the next day after each transfer made to the clearing account shall be recognized by the Energorynok as monetary payment for the electricity multiplied by the charge for the electricity distribution and supply calculated at the NCER tariff rate. In other words, the Company does not actually own the residual funds on the transit account as of 31 12 1997 - 867 th UAH, as this sum is going to be transferred to the Energorynok's clearing account the next banking day. Funds returned to the Company's settlement account in December 1997 amounted to 14.6% of collected and transferred consumer payments, which brings us to believe that out of 867 th UAH some 130 th UAH shall return to the Company.

### Note 3 Accounts Receivable

Debtors of electricity and heat as of 31 12 1997 totaled 1432 or 24 % of the entire number of payers for electricity and heat. The number of debtors decreased against 1996.

Total accounts receivable increased from 22096 to 36133 th UAH, or by 14037 th UAH, due to the growing sales volumes in 1997. With the sales volumes up by 52306 th UAH share of payments due was the same and amounts to 17 % of the annual sales.

The Company introduced a new settlement procedure in 1997 to its commercial suppliers that provide electricity transit to certain users in Poltava Region. Before that, such suppliers were paying with KW/h for using the Company's power lines and other facilities. Now they are paying money to the Company's settlement account, as well as promissory notes and mutual offsetting. Debts of commercial suppliers of transit electricity are considerable -

8177 th UAH (22 % of the total in this item of the Report on Financial Position, or 52 % of the payment due for the 1997 transit) As of 31 12 1997, nine out of thirteen commercial suppliers have debts to the Company, including BARI joint venture - 6964 th UAH But the Company's management is sure the debts will be paid before long

One fifth of the total debts for electricity - 7241 th UAH - are the debts of Poltava ore-dressing plant, one of the largest local consumers The plant has been using transit electricity suppliers over the past few years As the plant was facing some problems with independent commercial suppliers in the first half of 1997, it began to buy electricity from the Company The plant was unable to pay for the electricity in full and its debt to the Company (as of 31 12 1997) is 7241 th UAH The Company's management is sure the debt will be paid in full

In 1997, the Company managed to bring down debts of public utilities from 7600 to 3800 th UAH, i.e. almost by half mainly through mutual offsetting

Public utilities should be at least partially subsidized by the state in covering their losses In fact, they enjoy no support from the budget and become insolvent Therefore, mutual offsetting seems to be the only way to pay debts for the consumed electricity, under the circumstances The procedure is the following

- The Company shows the respective sum in its books as accounts receivable paid by public utilities for the electricity they use and as a decrease in accounts payable to the state budget in taxes,
- The state budget (the Ministry of Finance) enters this same sum in its ledgers as the Company's debts paid in taxes and as a decrease in subsidies due to be paid to public utilities,
- Public utilities show this sum in their books as the subsidies received from the state budget and as their debts paid to the Company for the electricity they use

The Company is actively using this method to ensure payments coming in and to redeem its own accounts payable to the budget Mutual offsetting performed by the Company in 1997, totaled 21960 th UAH

Debts by agricultural users amounted to 5550 th UAH, or 15 % of the total indebtedness Due to their own financial difficulties, agricultural users are limited in their ability to pay money for the electricity they use, so the Company managed to cut down these debts in 1997 by bartering farm products with its own creditors provided there was a mutual interest As of 31 12 1997, overdue accounts receivable (when default exceeds 30 days) was 28128 th UAH, or 75 % of the total indebtedness as compared against 66 % in 1996 Such an increase may be explained by the lack of funds and nonpayment crisis

The Company expects to have all accounts receivable for 1997 and what was left in the preceding years and does not plan to establish a doubtful debts reserve

#### Note 4 Other Accounts Receivable

Other accounts receivable are mostly debts by Kremenchuk HPP - 3934 th UAH, while as of 31 12 1996 it was the Company that was in debt to it for the electricity purchased - 7521 th UAH In 1997, the Company did several offsetting that resulted in

- fewer debts of budget structures to the Company,
- accounts payable paid by the Company to Kremenchuk HPP,
- fewer debts of Kremenchuk HPP to the budget in paying taxes

fewer subsidies due to be paid from the state budget

**Note 5 Inventory**

Inventory is shown in the Report on Financial Position at the purchasing price. The Company's inventory is mostly cables and fuel which are items with quick turnover and their cost as reflected in the Report is, actually, their fair value.

To calculate cost of goods sold, the Company uses the method which allows to specify concrete elements of the inventory that have been actually used.

Inventory includes the following elements (th UAH)

	As of 31 12 1996	As of 31 12 1997
Production stocks	1791	2303
Low-cost and quickly-worn items	755	982
Other	11	22
<b>TOTAL</b>	<b>2557</b>	<b>3307</b>

**Note 6 Other Circulating Assets**

A considerable share in the Company's other circulating assets were overpayments of profits taxes to the state budget - 364 th UAH and 225 th UAH as of 31 12 1996 and 31 12 1997, respectively. Overpayment is the result of mandatory tax prepayments to the state budget according to the effective Ukrainian legislation. The amount of overpayment is carried over while making further, decreased payments to the budget. Besides, the state owed compensations for VAT as of 31 12 1996 - 443 th UAH and as of 31 12 1997 - 434 th UAH.

The total state debt to the Company among other circulating assets as of 31 12 1996 was 26% and as of 31 12 1997 50%.

As of 31 12 1997, those were mainly advance payments to suppliers of inventories - 409 th UAH.

**Note 7 Capital Assets Houses, Constructions, Equipment**

The Company has the following structure of its capital assets (th UAH)

	Production capital assets		Non-production capital assets	
	1996	1997	1996	1997
Initial cost	470 715	476 241	0	0
Amortization	224 241	239 982	0	0
Residual cost	246 474	236 259	0	0

Amortization level of production capital assets as of 31 12 1997 was 50% of the initial cost. Besides, this item of the Report on Financial Position also includes

- cost of incomplete general refurbishment of production capital assets, 196 th UAH as of 31 12 1996
- incomplete capital investments in production capital assets, 2855 th UAH as of 31 12 1996
- 3201 th UAH as of 31 12 1997

- cost of equipment before installation,  
100 th UAH as of 31 12 1996  
55 th UAH as of 31 12 1997

Upon completion of general refurbishment of capital assets and capital construction the respective accrued costs shall be carried over as the capital assets cost along with further amortization

From 1997, the Company accrues depreciation using the method of double reduction of the balance Norms of fixed assets depreciation accrual are

- buildings and constructions — 5%,
- transfer devices — 5%, and
- machines and equipment — 15%

Availability of productional fixed assets per separate groups is reflected in the table below (UAH th )

	As of 12/31/96	As of 21/31/97
Buildings and constiuctions	26,483	29,043
Transfer devices	367,066	369,332
Machines and equipment	71,147	70 274
Other fixed assets	6,019	7,592
Total	470,715	476,241

According to the system of Ukrainian administrative accounting, book value of non-productional fixed assets in the balance sheet of the Company as of 12/31/96 and 12/31/97 was UAH 4,133,000 and UAH 5,064,000, respectively, and residual value — UAH 2 900,000 and 2,299,000, respectively, all this — value of residential buildings As the bodies of state power decided on transfer of departmental housing to enterprises of public utilities the Company in fact is not the owner of these fixed assets and cannot account on utilization of these assets and receipt of economic profit in future That is why the Company management considers it economically expedient to exclude the value of housing from fixed assets in the Statement of Financial Position

**Note 8 Intangible Assets**

Intangible assets of the Company include software which is accounted for at purchase price Amortization is accrued in a linear method during five or ten year period

**Note 9 Assets of Kremenchuk HPP Included in Company Statutory Fund**

Separate line in the Statement of Financial Position shows the value of circulating assets of Kremenchuk HPP included in the Company Statutory Fund — UAH 18,581,000 Pursuant to the Decree of the Cabinet of Ministers of Ukraine # 26/92 dated 12/31/92 heat and power plants are not subject to privatization, that is why in 1996 according to joint order of the Ministry of Energy and the State Property Fund vale of fixed assets of Kremenchuk HPP not subject to privatization was excluded from the statutory fund

The Company cannot dispose of assets of Kremenchuk HPP which is economically independent, has its own settlement account in the bank, independently incurs expenses and receives profit, defines income and pays taxes In near future, Kremenchuk HPP will separate from the Company with all fixed and circulating assets belonging to it, and the issue on reflection in the Company reporting of the part of statutory fund which corresponds to the value of HPP circulating assets will be resolved

#### Note 10 Accounts Payable

Main creditor of the Company is the National Dispatch Center of Ukraine from which it purchases most electric energy for transfer and distribution to the consumers of Poltava region. As of 12/31/97, debts of the Company to it was UAH 6,149,000.

As of 12/31/97, significant part of accounts payable of the Company were debts for the fuel — UAH 6,039,000 and goods and valuables — UAH 6,149,000.

#### Note 11 Other Short-Term Liabilities

The largest percentage in other short-term liabilities of the Company belongs to its debts on transfer of ecological surcharge on the tariffs which is established by the Cabinet of Ministers of Ukraine, confirmed by the price lists and paid by electric energy consumers (except citizens). This surcharge is collected by energy distributing organizations and has special purpose — in 1996 it was directly transferred to the account of Zmiyivska power plant in order to form the fund for reconstruction of production facilities, in 1997 — through the clearing account of Energorynok. These amounts were UAH 12,116,000 as of 12/31/96 and UAH 13,580,000 as of 12/31/97.

This item includes advance payment by the consumers for electric and heating energy — UAH 9,416,000 as of 12/31/96 and UAH 2,240,000 as of 12/31/97. Decrease of this debt reflects continuation of non-payment crisis in Ukraine, inability of energy consumers to make advance payments.

The Company had debts to the Ministry of Energy of Ukraine on deductions to centralized funds in the amount of UAH 956,000 and 1,390,000 in 1996 and 1997, respectively. Centralized funds, namely investment and innovation funds, are formed by the Ministry of Energy of Ukraine from mandatory deductions of energy companies for funding of large investment and scientific and research programs which are important for the whole industry sector.

Debts of the Company to its employees on salaries was UAH 1,312,000 and 506,000 in 1996 and 1997, respectively. During 1997, the Company controlled quite strictly growth of expenses for salaries trying to save expenses and receive profit, as well as to pay salaries to the employees on time and have no debts, and it succeeded in this. In conditions of non-payment crisis and cash deficit the Company uses barter settlements, namely receives agriculture products (food) from the enterprises which have debt for consumed electric energy, decreases their accounts receivable and distributes these products between employees on account of salaries.

#### Note 12 Statutory Fund

In definition of the statutory fund which as of 12/31/97 was UAH 55,240,000 according to the act of property assessment the following was included:

- UAH 36,659,000 — value of assets of electrical network enterprises, and
- UAH 18,581,000 — value of circulating assets of Kremenchuk HPP.

According to the Decree of the Cabinet of Ministers # 26/92 dated 12/31/92, heat and power stations are not subject to privatization. That is why in 1996 the joint order of the Ministry of Energy of Ukraine and the State Property Fund excluded from the value of the Company statutory fund the value of fixed assets of Kremenchuk HPP which are not subject to privatization. (See Note 9).

Statutory fund of the Company consists of 22,096,000 common registered shares with the nominal value of UAH 2.5.

### Note 13 Additional Capital

Item "Additional Capital" includes the following funds (UAH th )

	As of 12/31/96	As of 12/31/97
Funds received from the state budget for capital investments	585	585
Own funds for capital investments	1976	2769
Material valuables received for free	83	83
Financial aid of the Ministry of Energy of Ukraine	300	300
Intangible assets	4	4
<b>TOTAL</b>	<b>2947</b>	<b>3848</b>

Funds from the state budget received by the Company (in 1995) had special purpose and were allocated on construction of the networks for village electrification (10-35 KV) connected with action of the Law "On Priority Development of Agri-Industrial Complex"

Free receipt of material valuables took place when electrical networks were transferred by other non-energy-distributing companies to the Company balance sheet for servicing. The Ministry of Energy of Ukraine provided financial aid to the Company in order to form emergency reserve of wires and pillars for repair and construction of electrical networks.

### Note 14 Sales

To define the volume of sales, the Company used accrual method. According to this method, sales are recognized at the moment when electric and heating energy are received by the consumer and this is confirmed by the data of meter and the bill issued by the Company. During 1996 and 1997 the volume of Company sales was (UAH th )

	1996	1997
Total	164,693	216,999
including electric energy	164,122	216,378
heating energy	571	621

Dynamics of sales volumes was influenced (in the same direction) by three factors:

- 1 Increase of energy tariffs (established by the state in Ukraine),
- 2 Increase by 16% of energy consumption by the consumers in the region (KW/h). The main reason for this is appearance of new powerful consumers of electric energy because Kremenchuk HPP began to sell all generated energy to the enterprise Energorynok with transfer to the company of those consumers with which it had agreements on energy distribution previously, and
- 3 Appearance of electric energy transit operations among sales due to change in procedure of settlements with the distributors of transit electric energy.

First factor caused sales volume increase in 1997 by UAH 10,082,000, second factor — UAH 26,412,000, third factor UAH 15,812,000. Total growth was UAH 52,306,000, or 32%.

### Note 15 Prime Cost

Prime cost of goods sold of the Company consists of expenses directly connected with

- expenses for purchase and transfer of electric energy, and
- expenses for generation of heating energy.

In total amount of prime cost of goods sold the largest percentage belongs to the value of purchased electric energy. These expenses were in 1997 — UAH 177,387,000 or 84%, in 1996 — UAH 143,384 or 88%. Increase of expenses for purchase of electric energy in 1997 was caused by growth of its sales to consumers in the region.

The Company purchased electric energy from different distributors, namely (UAH th )

	1996	1997
National Dispatch Center of Ukraine	119,222	162,617
Kremenchuk HPP	13,370	10,386
Independent commercial distributors	10,680	3 841
Others	112	543

Expenses for salaries and associated mandatory deductions to government funds (pension fund, employment fund, fund for liquidation of Chernobyl disaster results) in prime cost of goods sold were UAH 12,347,000 (6%) in 1997 and UAH 10,482 (also 6%) in 1996. The reason for total increase of expenses for salaries in 1997 was increase of salaries level according to the orders of the Ministry of Energy of Ukraine. The state which was the only owner of the Company represented by the Ministry of Energy took appropriate measures to preserve realistic level of salaries for employees of the energy sector in conditions of Ukrainian inflation economy. But in cases when decision on payment of bonuses and remunerations was in jurisdiction of the Company management, the issue was carefully considered taking into consideration difficult financial position and uncovered losses for previous years. Payment of bonuses in 1997 was significantly reduced.

#### Note 16 Administrative and Management Expenses

Amount of administrative and management expenses increased in 1997 in comparison to 1996 by 29% — from UAH 1,171,000 to 1,507,000, or by UAH 336,000. This included increase of expenses for salaries of the management and mandatory deductions to the state funds connected with it (pension fund, employment fund, fund for liquidation of Chernobyl disaster results) — by UAH 186,000.

The reason for increase of expenses on salaries in 1997 are presented in Note 15.

#### Note 17 Sales Expenses

Sales expenses in 1997 increased in comparison to 1996 by UAH 354,000 (from UAH 3,880,000 to UAH 4,234,000). Expenses for salaries of sales employees and mandatory deductions to the state funds connected with it increased by UAH 211,000. The reason for increase of expenses on salaries in 1997 are presented in Note 15.

Expenses for salaries of sales employees include payment of remuneration to employees for detection of electric energy theft. In 1997, these expenses were UAH 150,000. Inspectors and controllers of the Company discovered in 1997 4,845 such crimes.

This item also includes expenses for payment for services of the intermediaries which assist in repayment of debts of the consumers for electric energy, savings banks and post offices which accept payments from population and transfer them to the Company account.

#### Note 18 Other Operating Expenses

Most of other operating expenses of the Company consist of expenses connected with labor protection. As these expenses are very important for organization of normal production activities of the energy distributing company, they are attributed to this item of the Statement of Profit. Additionally, this item includes payment of land tax, tax on vehicle owners etc.

**Note 19 Profit (Loss) from Other Sale**

Profit of the Company from other sale in 1996 and 1997 includes (UAH th )

	1996	1997
Profit from sale of fixed assets, material valuables	5	22
Profit from leasing separate objects from fixed assets	16	5
Profit from sale of services	1,720	587
TOTAL	1,741	614

Services which the Company renders to outside organizations and natural persons are repair works, link-up to electrical network etc

**Note 20 Other Profit (Losses)**

Item "Other Profit (Losses)" includes (UAH th )

	1996	1997
Amount of sanctions received from energy consumers	3,518	3,362
Amount of sanctions paid by the Company	(864)	(114)
Different mandatory deductions established by normative documents	(1,038)	(1,134)
Profit of previous years	0	7,310
Other	(1,106)	(502)

The Company accrues and receives from energy consumers different types of sanctions, namely penalties for untimely payment, fines for violation of energy consumption regimes, for exceeding of the established consumption and capacity limits, fines for theft of energy. Among sanctions paid by the Company the largest percentage belongs to penalty for untimely payment for purchased electric energy which, in its turn, appears due to consumers' non-payments.

This item includes different mandatory deductions to the centralized funds of the Ministry of Energy of Ukraine state budget and non-budget funds established by the normative documents of Ukrainian administrative accounting.

UAH 7,310 of previous years profit appeared as a result of

- write-off of accounts payable on deductions to centralized funds as of 12/31/97 according to the new Law of Ukraine "On Taxation of Enterprise's Profit" (UAH 581,500 to innovation fund and UAH 502,500 to labor protection fund),
- write-off of UAH 4,385,000 accounts payable on recalculation of ecological surcharge according to the results of calculation check with the National Dispatch Center of Ukraine for 1996, and
- resettlements with transit electric energy suppliers for the use of Company networks by them in 1996 — UAH 1,841,000

**Note 21 Extraordinary Items**

Extraordinary items of the Company profit include accruals at the expense of Kremenchuk HPP which is a structural unit of the Company but financially independent. In the period when financial reporting of the Company for 1997 is compiled, status of Kremenchuk HPP is being considered but it is absolutely obvious that in the near future it will separate from the Company (as heating and power plant which according to the decree of the Cabinet of Ministers of Ukraine # 26/92 dated 12/31/92 is not subject to privatization). That is why

management of the Company considers justified to reflect accruals from HPP as extraordinary profits. These amounts were UAH 91,000 in 1997 and UAH 1,958,000 in 1996. Extraordinary items of the Company expenses include different payments to the Company employees connected with maintenance of their material situation, solving social problems in conditions of Ukrainian inflation economy (Inflation index in the country was 110% in 1997 and 140% in 1996). Such expenses were UAH 473,000 in 1997 and UAH 2,310,000 in 1996. In 1997, implementing the policy of expenses saving the Company significantly reduced such expenses.

**Note 22 Income Tax**

Amount of income tax reflected in the Statement of Profit and Loss is an actually accrued tax in accordance with Ukrainian accounting system and tax legislation.

**Note 23 Average Annual Number of Common Shares**

In 1996, the Company held preparation of the documents required for privatization and did not have any actually issued shares certificate on registration of initial offer of shares was received by the Company on January 16, 1997 and during the year the Company had 22,096,000 common shares owned by the state.

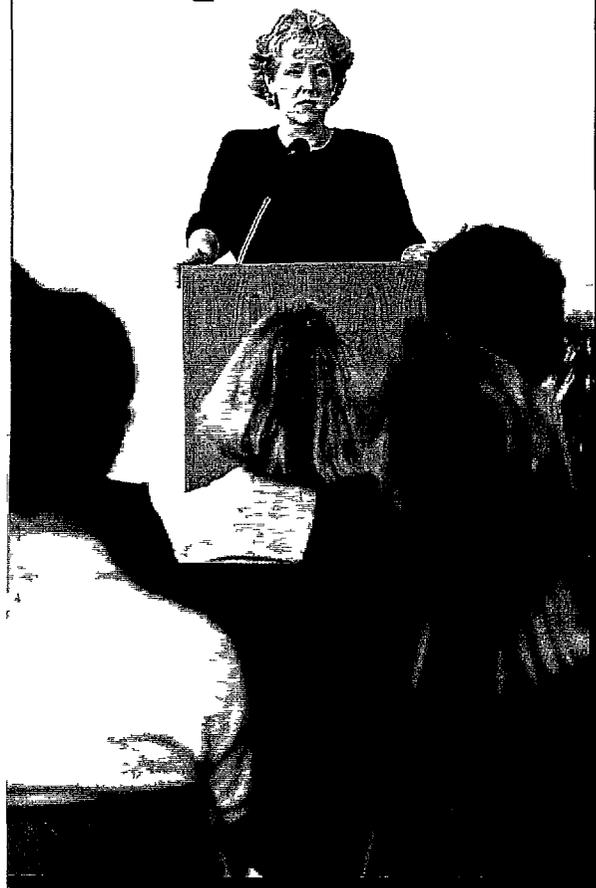
*Appendix 4 Sample Brochure Covers on “Invest Wisely,” and “General Shareholders’ Meetings”*

# РОЗУМНИЙ ПІДХІД



ІНВЕСТУВАННЯ

# ЗАГАЛЬНІ ЗБОРИ АКЦІОНЕРІВ



Sample Brochure covers entitled

- Invest Wisely
- General Shareholders' Meetings

*Appendix 5 Excerpt from the Brochure entitled "General Shareholders' Meetings"*

## General Shareholders' Meetings

If you purchased shares, you have become a shareholder. A joint stock company (JSC) has a statutory fund divided in a certain number of shares equal to the nominal value. Owners of the company are its shareholders. The top managerial body of a joint stock company is the shareholder general meeting. A shareholder has the right to

- Participate in and vote at the general meeting
- Elect the Supervisory Council, Management and Revision Commission
- Receive income, if there is any

All shareholders irrespective of the number and types of shares they own have the right to participate in the general meeting. Only owners of common stock, however, have the right to vote in the meetings, unless otherwise stipulated by the company's charter. Shareholders express their opinion as to the management of the company by means of regular elections to the Supervisory Council and executive bodies. The Supervisory Council represents shareholders' interests and oversees the company's management on their behalf. The Supervisory Council, Revision Commission and head of the company report to the shareholder general meeting.

Owners of shares should be properly informed in order to exercise their rights and elect the company's management, as well as to vote on relevant issues that may considerably influence activities of the company and well-being of its shareholders. This means that they should keep a thorough eye on timely provision of regular information on the activities of the joint stock company. Remember, the highest body of the joint stock company is the shareholder general meeting.

The general meeting approves the following issues

- The principal lines of activities of the company and to approve its plans and reports on their implementation
- Changes in the charter of the company
- Election, appointment and dismissal of members of the council of the JSC (Supervisory council)
- Election and dismissal of members of the executive body and revision commission
- Annual results of the activities carried out by the JSC, including its subsidiaries
- Reports and conclusions by the Revision Commission
- Procedure for profit distribution, and determination of the procedure for loss coverage
- Establishment, reorganization and liquidation of subsidiaries, affiliates and representative offices, and contents of their charters and regulations
- Decisions on company officials' property responsibility
- Rules of procedures and other by-laws of the company, and organizational structure of the company
- Purchase of company stock by shareholders
- Conditions for reimbursement to the officials of the company, its subsidiaries, affiliates and representative offices

- Contracts (agreements) concluded in amounts exceeding that which is indicated in the company's charter
- Decisions on termination of the activities of the company, appointment of the liquidation commission and to approval of the liquidation balance sheet

The general meeting of the JSC should meet not less than once a year. Meetings are considered to be valid if shareholders owning a total of over 60% of votes are present.

### **Authority of decisions made by the general meeting**

#### Decisions on issues of

- Introduction of changes to the charter of the company,
- Termination of activities of the company,
- Establishment and termination of activities of subsidiaries, affiliates and representative offices,

Are approved by the majority of  $\frac{3}{4}$  of those present at the meeting.

All other issues are approved by a simple majority of votes.

Decisions not included in the agenda of the meeting may not be approved by the general meeting.

### **The procedure for convocation of a general meeting**

According to Ukrainian legislation, JSC management should inform registered shareholders on general meetings, the time and place it is to be held, 45 days prior to the meeting.

Any shareholder has the right to make proposals to the agenda of the meeting not later than 40 days before the meeting. Shareholders with a total of 10% of the total votes may demand that their proposals be included on the agenda for a general meeting.

### **Extraordinary meetings**

#### An extraordinary meeting may be called

- By the management
- At the request of the Supervisory Council
- At the request of shareholders owning a total of over 20% of votes
- At the request of the Revision Commission

### **Pay attention to your rights**

If you own over 10% of the total votes jointly with other shareholders, you have the right to require issues to be included in the agenda of the meeting and require an inspection of management's financial and economic activities. You should not, however, forget that you may do it not later than 40 days before the meeting.

If you have over 20% of votes in total, you may require an extraordinary meeting for any reason and at any time. Should the management fail to fulfill your request within 20 days, you have the right to hold the meeting yourselves.

If you have over 25% of votes in total, you may block unfavorable changes to the company's charter, decisions on establishment or termination of activities of subsidiaries, affiliates and representative offices, and adoption of decisions on termination of activities performed by the JSC.

If you have over 40% of votes in total, you may block the meeting if you disapprove of the agenda.

#### **Advice to shareholders participating in general meetings**

Should you have any problems related to your shareholder rights, contact the department of shareholder rights protection at the address Kiev, B Khmelnitskogo St, 26, or at the telephone number 225-3040.

#### **What Does Disclosure of Information Mean and Why Does an Ordinary Shareholder Need an Issuer's Annual Report?**

One of the cornerstones of a properly operating stock market and the protection of shareholder rights is disclosure of information by an issuer, i.e., a report on a company's financial and economic activities which is to be submitted by an open ISC to the Securities Commission and then published in the mass media. In addition, these reports by issuers should be submitted to and kept at the Public Information Center established by the Commission and located on its premises. An issuer should compile its report in compliance with the Provisional Regulation on Filing Regular and Special Reports by Open Joint Stock Companies and Enterprises-Bond Issuers.

The information that should be made available through the Public Information Center includes

- Name, address, phone, fax and telex numbers
- Payment of dividends
- Date and minutes of the most recent annual meeting

General information on business activities for the previous year includes

- Main products or services rendered by the issuer
- Development of the sector in which the issuer works
- Degree of dependence on seasonal changes and degree to which competition is involved
- Contracts concluded but not yet fulfilled as of the end of the reporting period
- Future plans with regard to production, expansion, reconstruction, improvement of the financial position
- Circumstances surrounding fines and payment of fines for violations of existing

- legislation
- Fixed assets owned and used, as well as terms and conditions of use, degree of depreciation, use and restriction for use
  - The financial position and changes during the reporting period, as well as significant factors which can influence the issuer's future activities
  - The balance sheet and "Report on Financial Results and Their Use" for the reporting period
  - Other information which can be material for an investor's evaluation of the issuer's financial position and results of activities
  - Information on all securities' issuances (including those made in the reporting period),
  - Information on the management of the company and their replacements

Unlike other documents on financial and economic activities that have existed in Ukraine until now, this report is useful for both small and large investors because it contains a description of the activities carried out by the company while taking into account its future profitability. In addition, you as a shareholder will have to approve this report at the general shareholder meeting. Therefore it is very important that you review this document in a timely fashion. You can do this at the following address: 5 floor, 51, Gorkogo St, Kiev