

**Local Government and Public Service Reform Initiative (LGI)  
International Centre for Policy Studies**



**REPORT  
AUDIT FUNCTION SURVEY FOR UKRAINE**

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# 1. Overview of Budget Legislation and Laws that Regulate State and Local Budgets in Ukraine

## 1.1 Budget Legislation

The Constitution of Ukraine, the Budget Code and the Law of Ukraine on the State Budget have all contributed to the legal framework for budgets in Ukraine.

*The Constitution of Ukraine* — the main law of Ukraine that lays out the essentials of the budget system and the powers and functions of state authorities on all levels;

*The Budget Code* — a document regulating the relations arising in the process of execution, consideration, approval and implementation of budgets and reviewing the reports on their execution, as well as performing control over the execution of the state budget of Ukraine and local budgets;

*The Law of Ukraine on the State Budget* — a document stipulating the revenues and expenditures of the state for public needs, size and designation of such expenditures, and the division of the revenues and expenditures between the state and administrative-territorial units;

Other laws regulating the budget legal relations which come up in the process of execution, consideration, approval and implementation of budgets and reviewing the reports on their execution, as well as control over the execution of the state budget of Ukraine and local budgets;

Regulatory acts of the Cabinet of Ministers of Ukraine executed on the basis and with the purpose of implementation of the Budget Code and other laws of Ukraine regulating budget relations;

Regulatory acts of the central executive bodies executed on the basis and with the purpose of implementation of the Budget Code, other laws of Ukraine and regulatory acts of the Cabinet of Ministers of Ukraine regulating budget relations;

Decisions made by authorities of the Autonomous Republic of Crimea, local state administrations, self-government bodies made in correspondence with the Budget Code and other regulatory acts regulating budget relations;

Regulatory acts regulating tax legislation and indirectly affecting budget relations.

## 1.2 Local Budgets Legislation and Intergovernmental Fiscal Relations

The main legal acts that define the legal framework for the local government budgeting system in Ukraine are the Law on Local Self-governance in Ukraine, the Law on Local State Administration and the Budget Code of Ukraine.

*The Law on Local Self-Governance in Ukraine* stipulates the system and guarantees for the local self-governance in Ukraine, bases for organization and functioning of such self-government, legal status and responsibilities of the local self-government bodies and officials.

*The Law on Local State Administrations* stipulates the organization, powers and procedures for the activities of the local state administrations. Budget relations between the state and local self-government bodies

*The Budget Code* stipulates the relations between the state and local budgets, regulates the transfers of funds from regions-donors to regions-recipients.

Budget Code which was adopted in Ukraine in 2001 regulated the budget system, intergovernmental fiscal relations between different tiers of local governments and clearly specified the main elements of budget control system.<sup>1</sup>

Budget Code regulates all issues dealing with reviewing, adoption, execution and approval of their execution reports, as well as the control on State and Local Budgets.

Thus, **budget control** is a system of authorities and activities aimed at verification of legality and advisability of activities in the area of formation, distribution and use of the local self-government's fund. That means that effective control should be made on all stages of budget process.

Based on the Civil Code of Ukraine<sup>2</sup> **state financial audit** is one of the types of state financial control and envisions the examination and analysis the efficiency and legality of the actual state and public funds and property, other state assets use, accuracy of accounting and reliability of financial reports and functioning of internal control system.

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<sup>1</sup> Look up: Budget Code of Ukraine, Verhovna Rada of Ukraine on 21.06.2001 № 2542-III

<sup>2</sup> Look up: Civil Code of Ukraine Verhovna Rada of Ukraine on 16.01.2003 № 435-IV

## 2. Analysis of the main challenges of local government budget control system

### 2.1 State government audit and control of local budgets

#### 2.1.1 Types of Budget Control

According to the main stages of the budgetary process, budget control can be divided into preliminary, current and final control.

**Preliminary control** should be done on the stage of budget formulation, review and approval. It facilitates coordination of annual and strategic (medium-term) tasks of the local self-government for economic development; setting priorities for budget programs and local self-government activities. In conditions of scarcity of budget resources, this control should foster efficient and rational ways of provision of social services and consumption of budget resources.

**Current control** should be done during the process of execution of the local self-government budget and the budgets of budget-funded entities. It regulates:

- effectiveness on the basis of the primary documents — in order to timely prevent losses;
- effectiveness based on performance data and regular reporting — in order to react to the efficiency or inefficiency of economic activities; and
- adherence to the established norms and policy priorities; compliance with financial discipline.

**Follow-up control** should be exercised after the budget execution reports and the reports on the execution budget-funded entities' budgets are drawn up; this type of control is exercised during the audit process and general budget evaluation of the financial situation of a local budget. It is aimed at:

- detecting violations of budget legislation and non-adherence to the established priorities;
- checking the legality of transactions;
- verifying the reliability of reports;
- preventing abuse and taking measures to eliminate violations; and
- keeping government employees accountable.

**Graph 1. Main Methods and Uses of Budget Control**

| Control Stages | Uses  | Main Methods/Ways of Control  |
|----------------|---|---|
| Preliminary    | Checking whether the budgetary policy meets the national interests rather than political interests, the extent to which goals of budgetary policy are realistic and feasible (availability of conditions necessary to achieve these goals); economic evaluation of the advisability and efficiency of program performance measures; their compliance with State priorities; analysis of previous periods; recommendations on funding reserves; control of the established social standards. | Analysis, evaluation, survey, drawing up conclusions and recommendations    |
| Current        | Ensuring that budget appropriations are brought to notice of spending units; control over the execution of budget-funded entities' budgets; control at the stage of entering agreements and financial commitments; control over payments from budget accounts; and ongoing check-ups of the effective and efficient   | Tracking, analysis, review of documents, checks of accounts, and inspection |

| Control Stages | Uses   | Main Methods/<br>Ways of Control  |
|----------------|--|---|
|                | use of budget resources.   |   |
| Follow-up      | Check of the reliability of reporting data, balance statements, legality of transactions, compliance with legal norms and regulations; evaluation of program performance measures and efficiency of government activities; analysis of actual consumption and quality of budget services provided; control over efficient use of the State-owned and municipal property. | Audit, general and ad-hoc inspections, revisions, analysis, general budget evaluation |

### Internal Control/Audit

Pursuant to Article 26 of the Budget Code, financial control should be executed at all levels of the budgetary process and should ensure:

- continuous evaluation of how sufficient and consistent a budget-funded entity is with the requirements of internal financial control;
- evaluation of the consistency of results with the designated tasks and plans; and
- straightforward information to the senior management of the budget-funded entity on the results of each check-up (evaluation, investigation, study or audit) conducted by the internal financial control units.

Internal controls are rules and systems that allow managers and internal auditors to make decisions on valid and reliable fiscal data. These rules are established in the accounting system and used by managers but not by the accounting departments.

Spending units shall be held accountable for the organization, internal control and audit within its own and subordinated units. The senior manager is responsible for an efficient operating system of internal control over the financial and economic activity of the entity.

### External Control

**External control** and audit of the financial and economic activity of budget-funded entities shall be carried out by the Accounting Chamber; the State budget funds shall be supervised by the Chief Control and Audit Department of Ukraine pursuant to its responsibilities as the law prescribes.

During the fiscal year and at its end, at least five sets of several major entities monitor compliance of local receipts and expenditures with approved apportionment and payments or outlays.

First, the Code provides for local verification of budgets approved, apportioned and implemented by the local governments (Article 115).

Second, the State Treasury, through its regional units, would also account for all revenues and expenditures of local budgets and monitor budget execution to ensure that payments comply with commitments and budget appropriations (Article 112.1 through 3). This is the budget execution function of the Treasury.

Third, the Accounting Chamber verifies use of budget funds consistently with the State Budget Law (Article 110).

Fourth, the State Control and Auditing Administration reviews compliance with accounting procedures and efficient use of resources by local units (Article 113).

The local state administrations and executive bodies of corresponding local radas would serve as “supreme audit entities” and provide periodic and final post-audits on the approved budgets, budget apportionment, and budgets of spending units.

## 2.1.2 Responsibilities of state government bodies, responsible for audit and control

There are four major state government bodies responsible for local budgets audit and control (see table 1 below).

**Graph 2. Responsibility of State Auditing Bodies of Ukraine**

| Accounting Chamber   | Ministry of Finance   | State Treasury   | Chief Control and Audit Department  |
|--|---|--|---|
| <p>Controls the:</p> <p>1) use of the state budget funds in accordance with a law on the State Budget of Ukraine;</p> <p>2) formation, servicing and repayment of national debt of Ukraine;</p> <p>3) efficiency of use and management of state budget funds;</p> <p>4) use of budget funds, which local state administrations are responsible for and those, which are delegated to the local self-government bodies.</p> | <p>Controls the:</p> <p>1) meeting the budget requirements on each state of budget process, both for the state and for local budgets (if another is not foreseen by the law of Ukraine)</p> | <p>Controls the:</p> <p>1) carrying out the accounting of local budget revenues and expenditures;</p> <p>2) setting the unified rules of accounting and reporting on budgets execution estimates, issues the instructions that regulate these issues and controls their observance;</p> <p>3) correspondence of the disbursement of budget funds, budget obligations and budget allotments to the law.</p> | <p>Controls the:</p> <p>1) target and efficient use of state and local budget funds;</p> <p>2) target use and timely repayment of the loans took under the guarantee of the Cabinet of Ministries of Ukraine;</p> <p>3) accounting procedures and reliability of accounting reports on State and local budgets execution, budget estimates;</p> <p>Chief Control and Audit Department of Ukraine annually submits to the local financial bodies the consolidated results of the reports about the audits conducted.</p> |

Besides that, there are other local bodies responsible for the local budgets control. Verhovna Rada (Council) and correspondent councils in the sphere of control over the meeting budget requirements:

- control over the execution of the correspondent council decision on local budget;
- control over the reserve budget funds use;
- take other responsibilities, envisioned by the Budget Code of Ukraine and State Budget Law of Ukraine.

Control if the budget numbers, approved, budget estimates and budget institution estimates are made in accordance with budget legislation requirements. There are the following bodies, which are responsible for this task:

- Council of Autonomous Crimea Republic (ARC) – controls the budgets of cities of republic significance and rayon budgets of ARC;
- Oblasts state administrations – control rayon and cities (cities of local significance) budgets;
- Local state administrations in Kyiv and Sevastopol cities – control rayon administrations budgets in these cities;
- Rayon state administrations –control cities (cities of rayon significance), village and settlements budgets and their associations;

- Executive bodies of city councils – control the budgets in cities districts, villages and settlements or cities of rayon significance, that are of these cities jurisdiction.

## **2.1.2.1 Accounting Chamber**

### ***2.1.2.1.1 Basic functions of the Accounting Chamber***

The Accounting Chamber shall hold external control in the form of its right to revise and audit.

The audit function is the establishment and analysis of the facts in the process of execution of the state budget of Ukraine and their appraisal from the point of view of legitimacy, effectiveness and appropriateness.

The purpose of the audit is determined by the situation and whether the budget deals with state earmarked funds, currency and loan resources, other state funds connected with the state budget and its legitimacy and the effectiveness and appropriateness, as well as the appraisal, of the internal control of the entity being audited, making proposals to eliminate violations of the law.

The subject of the audit shall be the procedure of the use of the state budget of Ukraine, state earmarked funds, currency and loan resources, other state funds connected with the state budget of Ukraine, its movement, regulatory and legal acts, instructions and other documents concerning the activity of budget process participants.

***The objects of the audit*** of the Accounting Chamber shall be the Executive Office of Verkhovna Rada of Ukraine, Administration of the President of Ukraine, State Administration, Secretariat of the Cabinet of Ministers of Ukraine, executive office of the National Security and Defense Council of Ukraine, Secretariat of the Authorized Representative of Verkhovna Rada of Ukraine on Human Rights, National Bank of Ukraine, authorized banks and other financial institutions servicing funds of the State Budget of Ukraine, executive offices of Constitutional, Supreme and Supreme Economic courts of Ukraine, other court institutions, central authorities, executive office of the Prosecutor's General Office of Ukraine, other law enforcement and control bodies of Ukraine, Supreme Council of Justice of Ukraine, Central Elections Committee, local state administrations and local self-government authorities regarding their use of the State Budget of Ukraine and other budget institutions - administrators of the State Budget of Ukraine of all levels, other legal entities regardless of the form of ownership in case of their obtaining the funds of the State Budget of Ukraine, state secured loans; public organizations, political parties and others regarding their use of the funds of the State Budget of Ukraine and state earmarked funds, other objects regarding their use of the funds of the State Budget of Ukraine.

Subjects of the audit shall be officials of the Accounting Chamber, persons engaged by the Accounting Chamber to the audit as specialists or experts (see Section 3.1 External Auditors).

### ***2.1.2.1.2 Regularity of Audit***

The audits can be ordinary and extraordinary.

- **Ordinary audits** shall be conducted on the basis of the annual and interim working plans of the Accounting Chamber and its Board, annual and interim working plans of the departments and other authorized structural divisions.
- **Extraordinary audits** shall be included to the working plan and conducted upon the decision of the Accounting Chamber Board in cases stipulated by the Law of Ukraine on the Accounting Chamber.

#### ***2.1.2.1.3 Who uses the Reports?***

Conclusion reached by the Report after it is approved by the Accounting Chamber Board shall be submitted to the audited object. The latter should notify the Accounting Chamber about the results of consideration and measures taken by the audited object.

If the Accounting Chamber Board decides so, Report results will be sent to the Verkhovna Rada of Ukraine and/or its committees, and if necessary, to the President of Ukraine, to the Cabinet of Ministers of Ukraine, to the Ministry of Finance of Ukraine, to other central authorities.

If the audit detects facts of inappropriate use of the budget funds, other violations implying criminal or administrative liability, materials of the audit by the decision of the Accounting Chamber Board shall be filed to the Prosecutor's General Office of Ukraine, other law enforcement bodies or to the court in line with the procedure set by the law.

#### ***2.1.2.1.4 Level of transparency***

Results of the audits shall be made public through:

- reports and speeches in the Verkhovna Rada of Ukraine, its committees, the Cabinet of Ministers of Ukraine;
- participation in parliamentary hearings and "Days of the Government";
- publishing of the Report or part of it;
- issuing and dissemination of information and reference compilations, bulletins (special bulletins);
- press conferences, briefings, interviews;
- publishing and highlighting of the statements of the Accounting Chamber members or other executives of the Accounting Chamber in mass media;
- thematic TV and radio programs devoted to the Accounting Chamber;
- Internet web page;
- Mass media announcements about materials of the audit considered by the Accounting Chamber Board.

#### **2.1.2.2 Chief Control and Audit Department (CCAD)**

CCAD operates within the Ministry of Finance of Ukraine and is under the Ministry's of Finance of jurisdiction.

CCAD divisions in the Crimea Republic, oblasts, cities Kiev and Sevastopol are subordinated to the CCAD administration of Ukraine. Control and audit subsections (departments, groups) in cities' districts, and districts in towns are a part of oblasts Control and Audit subdivisions.

CCAD co-ordinates the activity with local people's deputies and executive power bodies, financial bodies, government tax service, other supervisory bodies, bodies of public prosecutor's office, internal affairs, security service office.

##### ***2.1.2.2.1 Basic functions of CCAD***

CCAD administration of Ukraine is responsible for the following in the Republic Crimea, oblasts, cities Kiev and Sevastopol:

- Organising the control and audit subsections in the ARC, oblasts, cities Kiev and Sevastopol after conducting of state financial control, summarizing the consequences of state financial control and in cases foreseen by the legislation, submitting the reports to the executive legislative authorities;
- Conducting within the supervised bodies the audits of financial and economic activity, using and saving of financial resources, irreversible and other assets, accuracy in identifying needs in budget funds and taking of obligations, status and the extend to which accounting standards and financing reporting are met;
- Conducting state financial audits of the implementation of government (budgetary) programs, the activity of budget institutions, the subjects of state management and other subjects of state management that are given facilities from the budgets of all levels and state funds or use (used during a monitored period) state or communal property;
- Providing control after failings and violations identified during state financial control;
- Developing legal and normative acts and instructions on the questions of state control;
- Carrying out methodological guidance and control after inferior audits and control subsections, summarizing the experience of the state financial control system and diffusing it among audit and control services and developing suggestions in relation to the improvement of the state financial control system;
- Verifying government purchases and carrying out other functions in accordance with Law on the Government Procurement of Goods, Works and Services.<sup>3</sup>
- Controlling the use by political parties of the facilities abstracted from the state budget spent on funding their activities;
- Examining leaves, statements and complaints from citizens about violations of legislation on financial questions. Appealing reports of thefts, peculation, shortages and other serious offences and immediately sending them to law enforcement authorities for further action.
- Controlling the audit and control subsections (departments, groups) in districts, cities and districts in towns.
- Auditing and controlling the subsections (departments, groups) in districts, cities and districts in towns and performing certain functions envisioned by article 8 of this Law.

#### ***2.1.2.2.2 Regularity of Audit***

The CCAD checks the compliance of the budget execution with the approved budget and other laws, and in case of flaws the CCAD may initiate the application of administrative penalties or hand the case over to law enforcement bodies.

The CCAD carries out scheduled and unscheduled inspections.

For scheduled inspections, the CCAD has developed criteria for the selection of entities.

Unscheduled inspections (19% of the total number of inspections) are carried out following complaints from citizens and organisations (0,8%), requests of government and parliamentary committees (5,4%), and requests of law enforcement bodies, such as prosecutors and police (12,8%). In total, 92,000 entities including 51,000 budget institutions are controlled every three years.

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<sup>3</sup> Look up: law of Ukraine on government procurement of goods, works and services of 22.02.2000 № 1490-III

### ***2.1.2.2.3 Who uses the Reports?***

Specialists of CCAD are obliged to submit audit reports to the law-enforcement agencies and inform them if cases of abuse or violations of the law by the state authorities and authorities responsible for state property management have been recorded.

Documents used in the controlling process (official and supportive documents) are to be submitted to the appropriate law-enforcement agency with a cover letter denoting the subject of state financial control.

### ***2.1.2.2.4 Level of transparency***

Specialists of the CCAD have to guarantee that the commercial and official secret requirements, defined by the law are met. That means that the information of the reports is not freely accessible to the public.

## **2.1.2.3 State Treasury**

### ***2.1.2.3.1 Basic functions of State Treasury***

In line with Article 48 of the Budget Code, the treasury form of State budget servicing requires that a treasury body must perform the following functions:

- cash transactions involving State budget funds;
- cash-settlement servicing of spending units, including payments based on orders from the key spending units;
- overseeing execution of budget authorities related to recording receipts, undertaking commitments, and making payments from budget accounts; and
- accounting for budget operations and developing budget execution accounting statements (in pursuance of Article 58, the State Treasury must draw up statements of expenditures based on reports by spending units on the execution of budgets of budget-funded entities by budget entities).

The main idea is that the treasury has no rights to command or control the use of budget funds. All rights belong to those spending units which have budget appropriations provided for in the law. Treasury servicing is an expenditure control system and a system to make payments. Thus, the treasury concentrates all payment operations of the budget on its accounts and performs ongoing control at the stage that precedes the allotment of funds from the State budget and making payments from budget accounts.

Establishing a system of ongoing control over the process of entering budget commitments by spending units requires that:

- those amounts of appropriations that are specified in the Budget Apportionment are brought forward to each budget-funded entity or organization through treasury bodies;
- each budget-funded entity or organization is given a ceiling of budget commitments within which it may make decisions and enter budget and financial commitments;
- no one contract of a budget-funded organization may be entered without registration with the corresponding treasury body; it cannot be allowed to enter commitments that obviously exceed real cash constraints of the budget;
- the contract must be executed; the treasury should know when and what amount has been paid to the organization's account and only after the organization confirms that the contract has been executed, the payment can be made.

The accountant of any organization should work along the following lines: the order for payment cannot be issued until goods/inventory items are delivered to the storage, and inventory tag is issued.

The treasury model allows the State to resolve the main budgetary problem — the problem of accounts payable in the budget funded-sectors — through workable contracts and orders, as well as through monitoring of the State's spending. Establishment of a settlement discipline is one task of the State Treasury of Ukraine and the treasury system as whole.

Creating a system for unified accounting of cash transactions ensures transparency of the budget execution due to timely provision of decision-making bodies engaged in budget management with detailed, reliable, and comprehensive information.

The main advantage of the treasury servicing of local budgets is that this approach does not ruin the mechanism of local budget execution but leads to improved budget discipline and ensures:

- efficient control over appropriate use of budget funds;
- accruing funds of spending units of local budgets on unified treasury accounts of departments of the State Treasury of Ukraine;
- transparency of cash flows and control over their appropriate use in line with budget appropriations;
- unified approach to accounting and reporting on local budget execution;
- availability of day-to-day data on balances on the accounts of all tiers of budgets and on the accounts of budget-funded entities (before the implementation of this pilot project, said data were only available on a monthly basis — in the monthly budget execution reports);
- flexibility in making decisions on budget resource management; and
- resolution of the problem of intergovernmental settlements.

#### ***2.1.2.3.2 Who uses the reports?***

According to Article 80 of the Budget Code, the local budget execution reports shall be submitted to the relevant radas by the Council of Ministers of the Autonomous Republic of Crimea, the local state administration, the executive body of the relevant rada, or the mayor of the rayon-significant city, village or settlement (if no appropriate executive bodies are created) within two months after the end of the budget period. The report shall be verified by the Accounting Chamber of the Autonomous Republic of Crimea (with respect to the use of funds of the budget of the Autonomous Republic of Crimea by bodies of executive power) or the budget commission of the corresponding radas. Upon consideration of the budget execution report by the sector commissions and the joint session of the budget commission, the draft decision is considered by the relevant local rada. The radas shall adopt budget execution decisions or make other appropriate decisions on this matter.

The quarterly and annual budget execution reports shall be submitted to the Supreme Rada of the Autonomous Republic of Crimea or the corresponding rada by the Council of Ministers, a local state administration, executive body of the relevant rada, or the head of the rayon-significance city, village or settlement (if no appropriate executive bodies are created) within two months after the end of the budget period.

#### ***2.1.2.3.3 Regularity of Audit***

The periodicity, structure and deadlines for submitting reports on the execution of local budgets shall be established by the State Treasury of Ukraine according to the requirements on the State Budget execution in Article 58-61 of Budget Code (Article 80.1).

Reports on local budgets execution and other financial reports shall be drawn up by regional bodies of the State Treasury of Ukraine in compliance with the rules and forms established by the State

Treasury on approval by the Ministry of Finance of Ukraine and the Accounting Chamber. Summarized indices on the execution of budgets shall be simultaneously submitted by regional bodies of the State Treasury of Ukraine, respectively, to the Ministry of Finance of Ukraine, financial bodies of local State administrations, and executive bodies of corresponding radas according to provisions of Article 58-61 of the Code (Article 80.2).

Article 58 contains general requirements on the submission of reports:

- summarizing, composing, and filing reports on the local budget execution are responsibilities of bodies of the State Treasury of Ukraine;
- spending units, in accordance with the single reporting methodology, shall compose and file detailed reports containing accounting statements, data on budget execution, results of activities, and other information required by the forms, as established by Ukrainian legislation;
- unified forms of reporting on local budget execution shall be established by the State Treasury of Ukraine on approval by the Ministry of Finance of Ukraine; and
- reporting on local budget execution shall be operative monthly, quarterly and annually.

Article 59 states that monthly reporting on local budget execution shall be submitted by the State Treasury of Ukraine corresponding to local financial bodies in line with the following timetable:

- monthly reporting on local budget execution — no later than on the 15th day of the month following the accounting month;
- summarized indices of reports on the execution of budgets, information on the execution of protected items of the local budget, and on the use of money of the reserve fund shall be submitted by the State Treasury of Ukraine no later than on the 25th day of the month following the accounting month. The report on budget debts shall be submitted no later than on the 15th day of the second month following the accounting month.

Article 60 defines the components of the quarterly report on the local budget execution:

- report on the financial status (balance sheet) of the local budget;
- cash flow report;
- report on the execution of the local budget;
- information on the status of the debt of the Autonomous Republic of Crimea or local self-government;
- summarized indices of reports on the budget execution; and
- report on credits and operations related to State guarantees of commitments.

In pursuance of Article 80.3 of the Budget Code, collection bodies must file the following reports to local financial bodies:

- monthly report on actual receipts of taxes and fees (obligatory payments) and other budget revenues and a monthly report on tax arrears, including the outstanding and overpaid amounts (broken down by industry and region, as well as by revenue source and ownership form), no later than the 12th day of the month, which follows the accounting month; and
- quarterly report on losses in revenue resulting from tax exemptions, on the amounts of restructured and written-off debts (broken down by industry and region, as well as by revenue source and ownership form), and the amounts of deferred and spread payments, no later than 35 days after the end of the quarter.

Article 61 of the Code establishes the structure of the annual report on execution of the local budget:

- report on financial status (balance sheet) of the Local budget;
- report on execution of the local budget;
- cash flow statement;
- information on the execution of protected expenditure items of the local budget;
- report on arrears;
- report on the use of the reserve fund of the budget;
- information on the status of the debt of the Autonomous Republic of Crimea or local self-government;
- report on credits and operations related to State guarantees of commitments;
- summarized indices on execution of budgets;
- information on the execution of local budgets; and
- other information recognized by the Council of Ministers of the Autonomous Republic of Crimea or relevant local rada as required for further explanation of the reported data.

When completing the forms for financial reporting on operations in kind, amounts shall be expressed in the national currency. Importantly, reports shall contain data on both revenues and cash expenditures in the full amount.

In case the Treasury form of budget execution is applied, monthly financial reports shall be checked and sanctioned by the body of the State Treasury of Ukraine (which with which registration accounts of the entity are opened) for conformity of the data of the Treasury accounting; the report shall be signed and sealed.

The bodies of the State Treasury of Ukraine and spending units shall be held responsible for the credibility of the data in the forms of financial reporting and their conformity with the data of the bodies of the State Treasury of Ukraine.

#### ***2.1.2.3.4 Level of transparency***

Officially the reports of the State Treasury could be submitted to the legal entity or individual on the special request, in this case the legal entity or individual needs to provide justifications why they need the specific reports of local governments. However in practice it is difficult to obtain this report, if there are no special contacts in the government.

#### **2.1.2.4 Ministry of Finance of Ukraine**

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

### ***2.2 Audit and control provided by local government***

#### **2.2.1 Intergovernmental fiscal relations system**

The Budget Code divides expenditures between the budgets based on the following principles:

- ✓ maximal harmony between the expenditure assignments for provision of budget services and the tier of government responsible for legal regulation, financial support and provision of these services (principle of relevance);
- ✓ concentration of budget expenditures on specialized types of social services at the oblast level to facilitate saving of budget resources (economies of scale).

Expenditure assignments related to the maintenance of the Constitutional order in the State, State integrity and sovereignty, independent litigation, as well as other assignments provided for under the Budget Code and included in this group are funded exclusively by the State budget of Ukraine and cannot be delegated to the Autonomous Republic of Crimea or any local government.

The Budget Code establishes the responsibility of the central government for funding State social programs. The funds for implementation of these programs are transferred to the local level via a mechanism of targeted subventions from the State budget.

Thus, according to Article 102 of the Budget Code, expenditures of local budgets for the implementation of governmental social protection programs (benefits for veterans of war and labor, cash aid for families with children, additional payments to the population to cover payments for housing and utility services, compensation payments for reduced-fare transportation of certain categories of citizens) are funded at the cost of subventions from the State budget of Ukraine in accordance with the procedure established by the Cabinet of Ministers of Ukraine.

In order to assure a better efficiency, expenditures of the State budget may be passed on to local budgets along with those defined as local by the law of Ukraine. Expenditures of local budgets are funded at the cost of assigned revenues taken into account in defining the amounts of intergovernmental transfers and transfers from the State budget.

To provide financial resources for the expenditure assignments delegated to local budgets, The State cannot delegate to the Council of Ministers of the Autonomous Republic of Crimea or local self-governments any expenditure assignments unless budget resources (in the form of assigned national taxes, fees, mandatory payments or shares thereof or transfers from the State budget of Ukraine) are passed to them. At the same time, the Council of Ministers of the Autonomous Republic of Crimea, local state administrations, executive bodies of local radas, and the heads of settlements, villages, and cities (where relevant executive bodies are not available) must ensure the execution of the delegated expenditures.

Before the adoption of the Budget Code, it was possible for a higher-tier local rada to decide upon the sources of funding for one or other entity and these decisions usually changed from year to year. Therefore, local governments were not motivated to develop such entities. Moreover, they were not interested in analyzing their efficiency and usefulness for the territory. Article 86 establishes clear criteria for the division of expenditures among local budgets (see Graph 3).

Budget services being assigned to particular tiers of government, local governments are motivated to provide better services and optimize the distribution of budget funds across the types of services with account for the needs of citizens of each particular territory. Besides, money can now be spent for the development of the local budget-funded entities without fear that next year these entities will be funded by another budget.

**Graph 3. Criteria for division of the types of expenditures between local budgets established by the Budget Code**

**First Group**

|   |   |
|---|---|
| Expenditures for financing those budget-funded entities and activities that provide essential social services guaranteed by the State and are located as close to the recipients as possible (funding of purely | Budgets of rayon-significant cities, settlements, villages, and their consolidated groups |
|---|---|

|  |   |
|--|---|
| local entities and activities).  |   |
| <b>Second Group</b>  |   |
| Expenditures for financing those budget-funded entities and activities that provide primary social services guaranteed by the State to all the citizens of Ukraine (funding of entities and activities for the entire population of rayons and oblast-significant cities).   | Budgets of cities of Republican (in the Autonomous Republic of Crimea) and oblast significance, and budgets of rayons |
| <b>Third Group</b>   |   |
| Expenditures for financing those budget-funded entities and activities that provide social services guaranteed by the State to particular categories of citizens of the whole region (funding of specialized entities and activities for particular categories of citizens that can be effective only within an oblast). | Budget of the Autonomous Republic of Crimea and oblast budgets  |

One major goal of regulation of intergovernmental fiscal relation is to provide the established expenditure mandates of local governments with adequate budget resources. In order to achieve this goal, expenditures of local governments are divided into those taken into account in defining the amounts of intergovernmental transfers and those not taken into account for that purpose. This division takes place only at the stage of budget formulation and is used for calculating the amounts of intergovernmental transfers from one budget to the other in accordance with the Budget Code. This division, however, does not mean that local governments are deprived of independence and freedom in making decisions with regard to budget expenditures in the process of formulation and passage of local budgets. The general approach is that the central government is responsible for financing of the expenditures taken into account in defining the amounts of transfers and reserves the control over the efficiency of these expenditures.

Articles 88, 89, and 90 of the Budget Code establish a clear division of expenditures between the tiers of government.

In accordance with the established division criteria, the Budget Code assigns special lists of expenditures to each tier of government, which are executed on a permanent basis and taken into account in defining the amounts of intergovernmental transfers. Articles 88 and 89 of the Budget Code clearly establish the types of expenditures to be executed from the budgets of villages, settlements, rayon-significant cities, and rayons and taken into account in defining the amounts of intergovernmental transfers.

Expenditures left by the State to the discretion of the local governments, which, therefore, are not taken into account in defining the amounts of intergovernmental transfers, include primarily those for the maintenance and development of communal infrastructure in populated areas — activities related to the development of housing stock, repairs and maintenance of streets, refuse collection, etc. The expenditures that the State leaves to the discretion of local governments are specified in Article 91 of the Budget Code, and the local governments make independent decisions as to their necessity, structure, and amounts.

The main resource for the expenditures specified in Article 91 of the Budget Code are the revenues that are not taken into account in defining the amounts of intergovernmental transfers (the so-called

Basket 2). Therefore, the levels of amenities, utility services, and own social programs of territories depends upon the mobilization of these revenues.

Village, settlement and city radas may delegate expenditures for the implementation of all or some of their own assignments to rayon radas or the radas of other territorial communities subject to simultaneous transferring funds to the relevant budgets in the form of intergovernmental transfers. The possibility to pool budget resources with the view of funding joint programs facilitates mutually beneficial activities, which are otherwise inefficient if not impossible.

### ***The Main Tenets of Local Government Revenue Formation***

Provisions of Article 61.4 of the Law of Ukraine on Local Self-governance in Ukraine declare that “independence of the local budgets is guaranteed through their own and nation-wide revenues assigned by law on a stable basis...”. At the same time, according to the Law of Ukraine On the Budget System of Ukraine (Article 15), which used to regulate these issues before the enactment of the Budget Code, the shares of main taxes payable to city budgets (rayon-significant cities), budgets of settlements and villages were established by higher-tier (rayon) radas and changed every year.

Articles 64, 66, and 69 of the Budget Code established the list of revenues assigned to various tiers of government with specification of types of taxes and fees assigned to their budgets.

One undoubtedly positive accomplishment in the formation of local governments’ revenue sources is the fact that the Budget Code not only stabilized the lists of revenues for local budgets but also fixed their sharing rates between different tiers of government. A higher-tier rada has no more the right to establish the share of any tax payable to the local budget, these are established legislatively.

The revenue structure of local self-government budgets is not random — it includes primarily taxes and duties collected on a residence basis. One of the fundamental principles of public finance is that only taxes paid by local citizens should be used for funding social services received by these citizens. The list of local taxes is consistent with international practices and demonstrates a close link between the amount/place of payment and the level of services that a taxpayer (who, at the same time, is a voter in his/her constituency) receives for this money. Local taxpayers are much more inclined to take interest in expenditure-related decisions by local governments and track implementation of these decisions, when they know that these decisions are implemented mainly at the cost of taxes they pay.

### ***Division of Revenues of the local budgets into Those Taken into Account in Defining the Amounts of Intergovernmental Transfers and the Ones Not Taken into Account for Those Purposes***

An important element of a local self-government system is creating incentives to increase revenue efforts, which will help local governments to finance the services they are responsible for. The most difficult problem inherited from the old system was the lack of interest on behalf of local governments in increasing their revenues. Any efforts to increase local revenues or activities aimed at the reduction of expenditures used to come naught by automatic cut in the share of shared taxes or transfers available to the local government.

The Budget Code divided local budget revenues into those included in the calculation of intergovernmental transfers and those excluded from this calculation. The Code has introduced a concept of “local self-government revenue basket” for the budgets of territorial communities (villages, settlements and their consolidated groups). The revenue basket is a set of revenue sources

assigned to the budgets of local self-governments on a permanent basis and included in the calculation of transfers to these budgets (Article 64.2).

The revenues taken into account in defining intergovernmental transfers are those assigned by the State to a local budget to finance the expenditures calculated on the basis of norms of budget sufficiency. If the amount of said revenues is less than the amount of expenditures delegated by the State and calculated according to the formula, a transfer is given to the local budget (equalization grant) from a rayon budget to cover the difference.

Revenues not taken into account in the calculation of intergovernmental transfers are those that are fully retained by the relevant government and not taken into account in defining the amounts of equalization grants (positive and negative equalization transfers). These revenues are to be used to finance the expenditures delegated to local governments in full as prescribed by law. Composition of the so-called “second basket” revenues is defined in Article 69 of the Budget Code of Ukraine. The structure of own local self-government revenues includes receipts of local taxes and fees, enterprise profit tax paid by municipally owned enterprises, 60% of land tax (for budgets for rayon-significant cities, villages, and settlements), as well as revenue sources of capital budgets along with other revenues as defined by the Code.

The functions of budget control are divided between state and local budgets in line with the division of responsibilities for budget allocations. Expenditures of the local budgets, which called delegated from the state, which are equalized by the equalization grant – are controlled by the state. Transfers from the state budget (budget subventions) are under state control.

Expenditures which are of the local responsibility, which are not financed or co-financed by the state are the expenditures which are under local government control. However there are certain restrictions even in these kinds of spending (see the Chapter 2.2.4 Local governments: reasons for transparency and accountability)

## **2.2.2 Audit and control functions of local government**

The audit and control functions of local government are the functions of internal financial control. According to the Article 26 of Budget Code the **internal financial control** which is carried out at all stages of budgetary process, must provide:

- 1) permanent estimation of sufficient and accordance of activity of budget institution to the requirements of internal financial control;
- 2) estimation of activity on accordance of results to the set tasks and plans;
- 3) information of directly leader of budget institution about the results of every verification (estimations, investigations, studies or revisions) conducted by subsection of internal financial control.

The leader of budget institution is responsible for organization of the effective internal checking system after economic activity of this establishment financial and with an account:

- 1) positions of this Code and other legal normatively acts;
- 2) requirements of purposeful, effective and efficient management by the functions of every structural subdivision, correct differentiation of functional duties;

3) rules of record-keeping and control in relation to assets, passive voices, profits and charges of budget institutions;

4) providing of accordance of activity of budget institution to the requirements of internal financial control.

Managers of budget institutions carry responsibility for organization and state of internal financial control and audit both in the institutions and in jurisdiction of budget institutions.

However, in practice, in spite of the legislation requirements the share of the local budgets which are executed with the violations is quite high (from 60% up to 70%). Today local councils are unable to prevent these violations, because they don't have the necessary tools.

The problem lays in the contradictions between different legal acts, such as the Budget Code, the Law on Local Self-governance of Ukraine and the Law on Local State Administrations. Based on these three documents there is some duplication of the functions for budget execution and controlling on each level between local self-governments executive authorities and local state administrations, which are the authorities from Central government control.

In Ukraine the reform of financial control as the element of financial management is far behind from the reform of intergovernmental relations. The contemporary system of intergovernmental relations in Ukraine requires the development of the clear performance measures for delegated functions for control over the target and effective use of budget funds.

The assessment of the budgets execution for all tires of government gives an opportunity to define the typical distortions, cause by: the lack of the legislative norms for local self-governance and executive authorities on the stages of budget formulation and execution; the lack of the permanent control over the subordinated institutions and organizations; no effective preventive measures of on-going control; a lot of problems caused by non-cash forms of settlements. The typical violations for the regions are the inobservance of the procedure of distribution of the revenues between local budgets of different tires of governments. Besides it could be observed that the volumes of funding from the local budgets the institutions, which shall be maintained by the state funds are growing, violating the Budget Code.

One of the major problem of establishment and development of the efficient financial local internal control in Ukraine is the lack of the institutions, which could guarantee its effectiveness and efficiency in each of the separate regions. According to the Cabinet of Ministries Resolution on Ordering of the Structure of the Local State Administrations, in the Structure of the Administrations separate divisions are not envisioned.<sup>4</sup> In practice, the situation with the organization of internal control differs depending of the regions. In most of the oblast state administrations in their structural divisions there are the control and audit sections established, in certain oblast administrations the functions of the internal financial control is performed by the subdivisions which are the part of the line ministries; in some cases these subdivisions or sections are not created at all.

Thus the local self-government authorities don't have enough legal procurement and financial bases for making decisions on establishment and development of the system of local internal control.<sup>5</sup>

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<sup>4</sup> Look up: Regulation of the Cabinet of Ministries of Ukraine on the Ordering of Structures of Local State Administrations Official Bulletin, 2000

<sup>5</sup> I.M. Ivanova Problems of establishment of Municipal Financial Control System - [http://www.niisp.gov.ua/vydanna/panorama/issue.php?s=epol5&issue=2005\\_3](http://www.niisp.gov.ua/vydanna/panorama/issue.php?s=epol5&issue=2005_3)

### 2.2.3 Municipal companies audit

According to the legislative requirements the procedures of the internal financial control for the ministries and other executive authorities are developed by the Chief Control and Audit Department. Based on the Resolution<sup>6</sup>, the Cabinet of Ministries of Ukraine **recommends** to the local-self government bodies to introduce the procedure of internal financial control in the municipal enterprises. The procedure of internal financial control is defined in the Resolution. However, in fact, this kind of control is the external control by nature, because it is initiated by the state controlling authority – Chief Control and Audit Department.

In accordance to the Law on Local Self-Governance of Ukraine the internal control, shall be performed by the authorities of local self-government bodies. The relations of the local-self government bodies with the municipal companies that are owned by the correspondent territorial community, shall be based on principles of subordination, accountability and be under control of local self-governments.

The Law on Local Self-governance of Ukraine<sup>7</sup> notes that the management of municipal companies that are owned by the local self-government authorities is performed by the village, settlements and cities' radas.

The exclusive competence of the village, settlements and cities' radas is:

- establishment for the municipal companies, institutions and organizations, that are owned by the correspondent territorial communities the share of the profit that shall be dedicated to the local budget<sup>8</sup>;
- approval of the decisions on property alienation, according the Law of Ukraine on Transferring the Objects That are in State and Municipal Ownership<sup>9</sup>;
- approval of the local programs of privatization as well as the list of objects of communal property which are not the subject of privatization; defining the expediency, procedure and conditions of privatization of the objects of communal property; making decisions about the acquisition of privatized property, according to the defined by the law procedure, decision on including the objects of communal property, which were alienated in course of privatization based on the invalid agreement, decision on giving into concession the objects of communal property, on establishment, liquidation and conversation of the municipal companies, institutions and organizations of the correspondent territorial community;
- making the decisions regarding the transfer to other bodies the certain authorities as to the management of municipally owned property of the correspondent territorial community, defining the measures of these authorities and conditions of their performance.
- creating in case of necessity, the bodies and services which could guarantee together with other subjects of municipal property the joint funding of the municipal companies.

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<sup>6</sup> Look up: Regulation “On Conducting the Internal Financial Control by the Ministries and other Executive Bodies the Internal Financial Control”, Cabinet of Ministries of Ukraine, #685, 22.05.2002

<sup>7</sup> Look up: The Law of Ukraine on Local Self-Governance in Ukraine of 21.05.1997 № 280/97-BP

<sup>8</sup> However, in spite of this stipulation, in practice the share of the municipal company profit is defined by the Law on State Budget of Ukraine centrally.

<sup>9</sup> Look up: The Law of Ukraine on Transferring the Objects that are in State and Municipal Ownership of 03.03.1998 № 147/98-BP

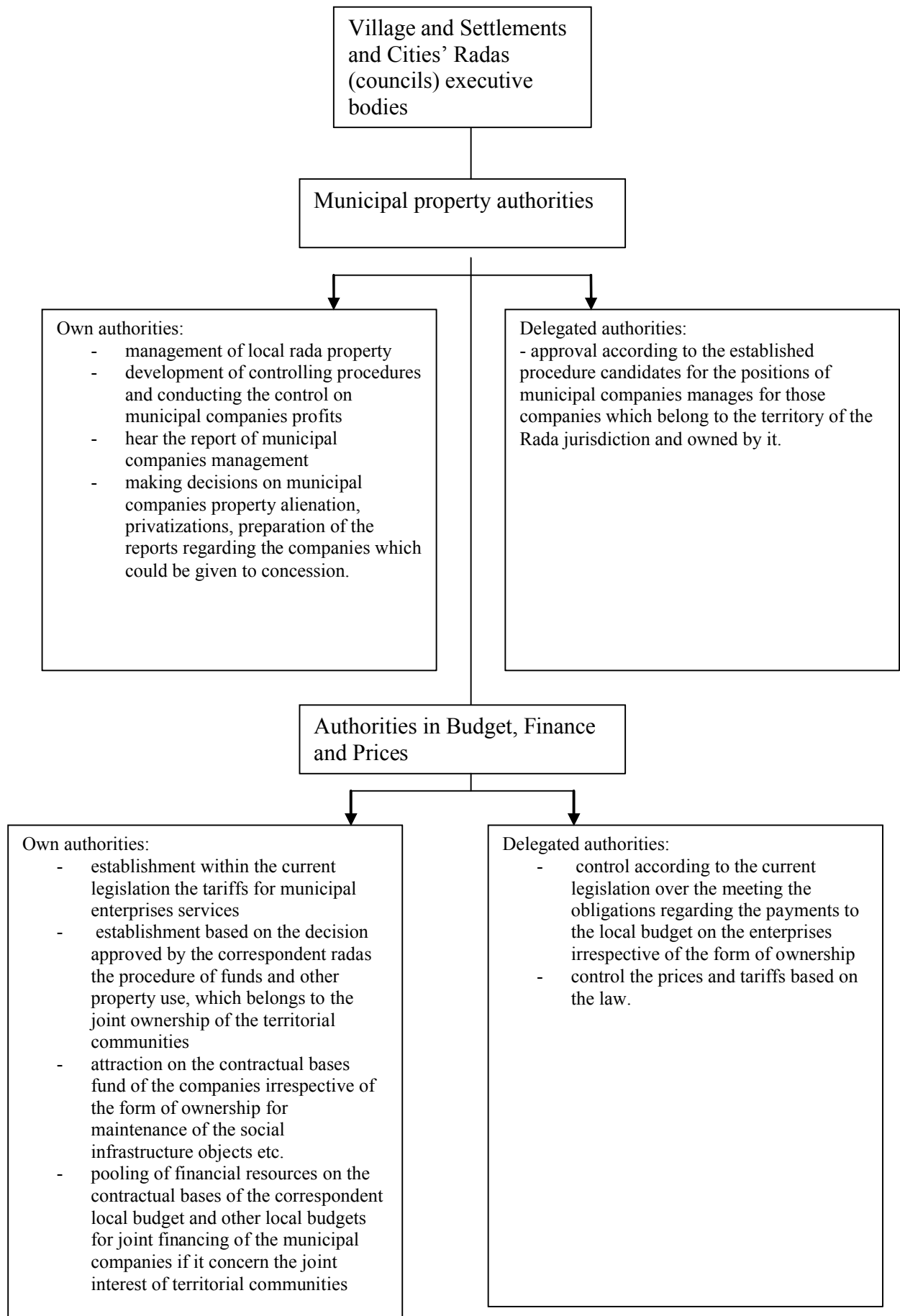
Communal companies' controlling functions are performed by the villages', settlements' and cities' Radas' executive authorities. Those functions based on the Law on Local Self-Governance of Ukraine concern the regulating the budget, finance and prices issues of the communal property management (see Graph 4 below)

Controlling functions are divided into own functions of local self-government body and the delegated functions<sup>10</sup> from the State. Therefore the authorities of local self-government body could be divided into own authorities and those delegated from the state.

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<sup>10</sup> Delegated functions – authorities of the executive authorities, which are the authorities of the local self-government bodies, as well the as the authorities of local self-governments, which transferred to the correspondent local state administrations based on the decision of the rayons' and oblasts' councils.

Graph 4 Municipal Property Management Authorities of Village and settlements Radas' Executive Bodies



## **2.2.4 Local authorities: Reasons for transparency and accountability**

The internal financial management and the internal budget control as the integral part of the local financial management system could be implemented on the initiative of the local management. However, this type of control concerns mostly the control over the own revenues and expenditures of the local self-government bodies (those, which are not taking into account while calculating intergovernmental fiscal transfers, see Section 2.2.1 Intergovernmental Fiscal Relations System).

Own revenues, these are the revenues which local self-government responsible for and which central government doesn't cut. Therefore local-self governments usually interested in increasing the volume of these revenues, because via these funds the municipality could finance development of the municipal infrastructure by building new hospitals, bridges, improve the city roads, fund additional local social programs etc.

The Budget for Development Fund is formed own revenues of local government, this fund is assigned to be spent for any municipal developments, such as capital investments.

According to the Budget Code of Ukraine, Budget for Development shall be formed by the following revenues:

- proceeds from the sale of communally owned assets, including from sale of land plots
- used for non-agricultural purposes;
- receipts of dividends paid on the territorial community's stake (stock, share) in
- statutory funds of business entities;
- proceeds from repayment of loans provided from the relevant budget prior to the
- enactment of this Code and interest paid for use of these loans;
- resources transferred from the other part of the local budget in pursuance of a decision
- made by the relevant Rada;
- borrowing raised consistent with procedures provided for under this Code and other
- laws of Ukraine (except for cases provided under Article 73 of this Code); and
- subventions provided from other budgets for implementation of investment projects.

The Budget for Development could include the following expenditures:

- repayment of the principal of debts of the Autonomous Republic of Crimea and local self-government (except for the debt arising as provided under Article 73 of this Budget Code);
- capital investments;
- contributions of authorities of the Autonomous Republic of Crimea and local self-government authorities related to their stakes in statutory funds of business entities.

The reasons when the municipality could be interested in having the internal audit and buy the external independent audits, in practice, are economic development and capital investments. Therefore the municipality is interested in attracting foreign and domestic investors and local municipal borrowings that again would be spent for capital investments.

According to Ukrainian legislation there are the set of requirements established by the Ministry of Finance for the municipalities that want to borrow money in banks or on capital markets. One of them is that the municipality needs to buy the Credit Rating from the nationally or internationally recognized agency. In order to get a rating, usually the municipally hires a local independent auditing company that collects all necessary information. Usually these kinds of services could be affordable for the municipalities with a budget no less then UAH 200 mln. Municipalities which have a small budget usually can't afford paying for these services.

Another reason for internal control could be the interest of the mayor to attract foreign investors, who would like to have the transparent budget information on the municipality in which they operate and prefer to read budget reports in an investors-friendly format.

### **3. Assess the capacity of Internal and External Auditors**

#### **3.1 External Auditors**

External audits of the financial and economic activity of budget-funded entities shall be carried out by the Accounting Chamber (see the Section 2.1.1 Types of Budget Control). According to the amendment to the Constitution that came into force in January 2006, the main goal of the ACU is to control the revenue and expenditure of the state budget of Ukraine on behalf of the Verkhovna Rada (Parliament of Ukraine). The ACU Act establishes the ACU as a control body, subordinated to parliament, and operated independently of any other state body and only accountable to the Verkhovna Rada.

##### **3.1.1 Adherence to the international standards**

In 2001 the ACU established a division of internal standards, analytics and development, with the objective of improving the effectiveness of ACU work. The division is currently staffed with 17 employees. The goal of the division is to prepare internal guidelines, give advice to auditors in the preparation and conducting the audits, and comment on the final audit reports from a methodological point of view. The establishment of this division shows the importance given to the development of ACU audit methodology. The division has already prepared a large package of 31 instructions and guidelines for auditors. These documents contain a set of procedures related to the organisation of work, preparation of reports and management letters, etc. The most important is the Accounting Chamber standard – procedure for preparation and conduction of audits and drawing up of their results.<sup>11</sup> The package also includes temporary guidelines for an effective audit, combining with the elements of legality and regularity with economy, efficiency and effectiveness. However, further developments in this respect are still needed, particularly with regard to more detailed guidelines focused on field auditing standards and responding to the question of “how to audit” rather than on procedures to follow.

Thus the existing methodological framework of the ACU audit work is insufficient, as it mostly focuses on procedural aspects. Therefore further work is needed to adapt the recognized international standards and to implement them.

##### **3.1.2 Qualifications of the Auditors and Trainings to Increase their Professional Capacity**

As for staffing issues, the ACU has adopted competitive recruitment procedures and, like other Ukrainian public institutions, has a policy of drawing from a “personal reserve” of potentially good candidates, such as previous ACU employees or experienced employees of governmental institutions.

Professional development programmes are based on two systems:

- system of obligatory training for civil servants, introduced by the Law on Civil Service, which requires every civil servant to undergo special refresher training every five years;
- own training activity developed by the ACU, which includes training carried out by university departments or professional organisations in the audit area (in Kiev and other cities where regional offices are located). Such training is carried out based on curricula prepared by the ACU.

A number of Ukrainian educational or professional institutions already offer studies in auditing. In addition, there are training events led by ACU staff responsible, for example, for the development

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<sup>11</sup> Look up: Board resolution of the Accounting Chamber of Ukraine 28-6 , 27.12.2004

of audit methodology or IT experts. The training programme for 2006 has been prepared on the basis of a questionnaire, in response to which all ACU employees specified their training proposals.

The overall intensity of training in 2005 was very high, with 368 ACU staff taking part in various forms of training. These training activities indicate the high importance given by the ACU to staff development. However, now it would be more beneficial to prepare a human resources strategy for a longer term, showing specific objectives to be achieved in terms of staff numbers, required qualifications and promotion schemes. This strategy would include a thorough assessment of training needs that would provide the natural framework for a specific training strategy.

For the past two years, as part of their obligations as civil servants, ACU staff have participated in an annual performance evaluation, which was carried out in accordance with the Law on Civil Service and included the employee's self-assessment of the supervisor's assessment. A more customised approach by the ACU would be needed.

The key weaknesses of the ACU are its small size and inability to effectively fulfil its mandate, a high proportion of analytical work compared to audit activities, and deficiencies on the methodological side of audit activity, related in particular to insufficient work on regularity audit, as understood by INTOSAI Auditing Standards.<sup>12</sup>

### **3.1.3 Cooperation with international organizations**

In accordance to item 12 of the article 6 of the Law of Ukraine on the Accounting Chamber of Ukraine Accounting Chamber shall cooperate with Supreme Audit Institutions (SAIs) of foreign countries and respective international organizations and conclude agreements on cooperation.

The Accounting Chamber of Ukraine became INTOSAI member in 1998. As a part of realization of INTOSAI Strategic Plan for 2005-2010 Accounting Chamber of Ukraine takes part in activities of INTOSAI Professional Standards Committee (Subcommittees on Compliance Audit, Internal Control Standards, Accounting and Reporting), INTOSAI Public Debt and Capacity Building Committees, INTOSAI Working Group on Environmental Auditing.

The Accounting Chamber of Ukraine became a EUROSAI member in 1999 and takes part in activities of EUROSAI Working Groups on Environmental Auditing (EUROSAI WGEA) and Information Technologies.

The Accounting Chamber of Ukraine is the Chair of the Special Subgroup on the Audit of Natural, Man-Caused Disasters Consequences and Radioactive Wastes Elimination established by the Resolution of EUROSAI WGEA in Luxemburg in 2006.

The Accounting Chamber is also a member of the Council of Heads of Supreme Audit Institutions of Commonwealth of Independent States - international organisation which develops cooperation and exchange of experience in the sphere of public audit on post-Soviet area. The second session of the Council took place in Kyiv (2001).

The Accounting Chamber develops vigorous cooperation with Supreme Audit Institutions worldwide. Currently, the Accounting Chamber has signed Agreements on Cooperation with Supreme Audit Institutions of Poland (1998), the Russian Federation (1998), Bulgaria (2002), Moldova (2001), Belarus (2001), Georgia (2002), Hungary (2004), Korea (2004), People Republic of China (2004), Lithuania (2005), Slovakia (2005), Armenia (2005), Azerbaijan (2006), Kazakhstan (2006). Consultations, exchange of experience on methodology and standards of auditing, procedures and methods of the audit, professional training and personnel skills development are foreseen by these Agreements.

Fruitful bilateral cooperation in the area of public audit has resulted in parallel and coordinated audits carried out during 2004-2007 by the Accounting Chamber and SAIs of neighbour countries

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<sup>12</sup> Look up: Ukraine Governance Assessment Report, SIGMA, March 2006.

in the field of environmental auditing (with SAIs of Belarus, Hungary, Poland, Russian Federation and Slovakia) and effectiveness of checkpoints (border crossings) at Ukraine-Poland border.

Accounting Chamber of Ukraine has been developing, on a regular basis, cooperation with European Court of Audit, World Bank, European Commission and SIGMA/OECD. Several Technical Assistance Projects were successfully performed in the Accounting Chamber in collaboration with UN (UNDP Project "Integrity in Action: On the Way to Public Accountability and Human Rights Protection"), European Union (Project "Audit of Public Finances") and Swedish Institute of Public Administration.

International cooperation provides for gathering new experiences and best practices through participation of our experts in international conferences, seminars and training programs dedicated to the most important issues of Public Audit.

The ACU takes active participation in international cooperation, in particular by carrying out parallel audits with other Supreme Audit Institutions. This activity should be continued as it is beneficial for further development of its working methods.<sup>13</sup>

### **3.2 Internal Auditors**

State Internal Financial Control in the Ukrainian public administration is currently subject to plans for substantial changes. According to these plans, the traditional ex-post control by a centralised inspection service would be replaced by a system based on the principles of the European Union for State Internal Financial Control, i.e. the introduction of managerial accountability for financial management and control, the introduction of decentralised internal audit, and the establishment of a central co-ordination and harmonisation function.

The Ministry of Finance of Ukraine together with the Chief Control and Auditing department (CCAD) developed the Concept of development of State Internal Financial Control which is approved by the order of the Cabinet of Ministers of Ukraine on May, 24, 2005 № 158-p.

The concept of development of state internal financial control over Ukraine is directed on change of ideology of the financial control over norms and rules of the European Union (EU) and improvements of legal field in the sphere of state financial control. And, in particular, provides introduction of new effective forms of control: internal audit and internal control.

In Ukraine the basis for local internal financial control is laid down in the Budget code (article 26). It defines the managerial accountability for establishing and implementing the local internal financial control system, although poorly formulated and not elaborated in secondary legislation. In fact, the concept of decentralised management accounting for local financial control is not introduced in Ukraine.

The system of internal local financial control is not regulated by any specific act, there is a set of legal acts that regulate separate cases, but there is no unified vision for what the local internal control system should look like.

Despite of the fact that some local governments established controlling divisions and sections within their executive commissions, the effectiveness of the work of these divisions and sections is quite low.

The capacity of the internal auditors is quite low as well, due to the:

- lack of interest of the heads of local administrations to control the bigger part of the local revenues, which state actually controls. This happens because of the fiscal dependency of local governments from the state budget;

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<sup>13</sup> Look up: <http://www.ac-rada.gov.ua/achamber/control/en/index>

- lack of strategic vision and low financial management skills of the specialists in local executive authorities;
- low financial motivation of the staff of the local administrations, uncompetitive salaries lead to the difficulties to hire a qualified labour force.

Thus, the establishment of the system of internal and external local financial control should be the integral part of the intergovernmental relations reform, which should be accompanied by the fiscal decentralization reform.