

# RESULTS

## OF ASSESSMENT OF PUBLIC FINANCIAL MANAGEMENT SYSTEMS IN AMALGAMATED HROMADAS



Based on the assessment of 15 amalgamated hromadas from 10 oblasts across Ukraine conducted by IBSER, the Institute for Budgetary and Socio-Economic Research, as commissioned by the U-LEAD with Europe Programme, and meetings with leaders and staff of amalgamated hromadas participating in Phase II of the Project "Assessment of Public Financial Management Systems in Amalgamated Hromadas" in June – December 2019.

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The Authors and the U-LEAD with Europe Programme would like to acknowledge the following contributors:

Heads and staff of **Velyka Severynka, Voinyliv, Voskresenske, Dubove, Illinivka, Klevan, Mala Liubasha, Nemyriv, Novopskov, Raivka, Sviatovasylivka, Sokolivske, Soledar, Chmyrivka, Yasky amalgamated hromadas** – for participation in the assessment, demonstrated openness and willingness to cooperate.

U-LEAD with Europe experts and advisors on local finance engaged in the assessment – for their support and assistance to hromadas in improvement of their public financial management systems: **Inna Sviatna, Olesia Holynska, Roman Vlasenko, Serhiy Ivakhnin, Iryna Kondratiuk, Anatoliy Matviuk, Inna Myronova, Andriy Muzhevskyy, Olena Savchenko, Oksana Shvets**.

IBSER experts working directly in hromadas and contributing with individual assessment reports on public financial management in hromadas with recommendations on potential improvements, high level of commitment and expertise demonstrated in their engagement with hromadas: **Viacheslav Zubenko, Andriy Kornienko, Viacheslav Holynskyy, Lidia Hladchenko, Maryna Shapoval, Tetiana Pautova, Tamara Shapoval**.

**DOBRE partner project** for sharing their assessment methodology serving as a reference point for this exercise and continuous information exchange in the field of local finance management.

Original is in Ukrainian

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## 1. BACKGROUND AND PURPOSE OF PUBLIC FINANCIAL MANAGEMENT ASSESSMENT IN AMALGAMATED HROMADAS

The U-LEAD with Europe programme (Ukraine – Local Empowerment, Accountability and Development Programme) is a multi-donor action of the European Union and its member states Denmark, Estonia, Germany, Poland and Sweden to support Ukraine in its movement towards a more democratic, stable and prosperous future. U-LEAD with Europe supports the decentralisation and regional policy reforms by providing legal and strategic advice on relevant legislation and policies. It strengthens the capacity of stakeholders in decentralisation and regional development at all levels with a primary focus on the development of hromadas and quality of life for its citizens. Improvement of the financial management in amalgamated hromadas and strengthening their institutional capacity to implement local self-government reforms are among top priority areas of the programme.

Based on the findings of the pilot project "Structures, instruments and procedures for local financial control in the hromadas", analysis of complementary data and documents, and consultations with DOBRE and other donors engaged at the local level, U-LEAD with Europe initiated a more in-depth analysis and assessment of the current status of local finance management in amalgamated hromadas. The objective was to evaluate the robustness of planning, execution, accounting and control of local revenues and expenditures in amalgamated hromadas.

In the period from November 2018 to March 2019, U-LEAD with Europe, jointly with the contracted consulting company "Centre of Information and Analytical Technologies", implemented Phase I of the public financial management assessment in 10 amalgamated hromadas from five Ukrainian oblasts and identified systemic issues that need to be addressed at the central government level. The DOBRE project's methodology was at the core of the adopted approach in the assessment of public financial management systems in hromadas. The final report of Phase I is available on the website decentralization.gov.ua.<sup>1</sup>

It became clear during Phase I that the assessment can provide a significant contribution towards improvement of public financial management at the local level, whereby hromada-specific reports and action plans offer useful input and insights for further development and better financial management in hromadas.

In light of such findings, U-LEAD with Europe decided to continue the assessments and cover a further 15 amalgamated hromadas in 10 oblasts in Phase II. This report is the final output of Phase II of the project "Assessment of Public Financial Management Systems in Amalgamated Hromadas", implemented by the Institute for Budgetary and Socio-Economic Research (IBSER), in partnership with the U-LEAD with Europe programme, and a team of finance advisors of Local Self-Government Development Centres (from 2020 – U-LEAD regional offices) in Vinnytsia, Volyn, Dnipropetrovsk, Donetsk, Ivano-Frankivsk, Luhansk, Odesa, Mykolaiv, Kirovohrad and Rivne oblasts in the period from June to December 2019.

The key aim has been to support hromadas in their efforts to: build effective financial management, with better understanding of the existing system of public finance; increase their capacity to manage own finances; achieve strategic development goals; and become more attractive places to live and to open and conduct business.

<sup>1</sup> [https://decentralization.gov.ua/uploads/library/file/479/10\\_AHs\\_assessment\\_final\\_report.pdf](https://decentralization.gov.ua/uploads/library/file/479/10_AHs_assessment_final_report.pdf)

The objectives of Phase II were to:

- ▶ Assess the degree of compliance with the existing rules and procedures, efficiency of management of financial resources by local self-governments of the basic level,
- ▶ Offer practical recommendations to improve the existing public financial management systems, minimise risks and increase fiscal capacity of hromadas, and
- ▶ Identify systemic issues in public financial management to be addressed at the central government level.

In each selected hromada, the assessment looked into strategic planning, budget management including administration of revenues and expenditures, accounting, assets management, procurement, and systems of data processing and storage. Another important focus was on budget transparency and accountability.

The assessment exercise consisted of several steps: preparation before visiting hromadas by accessed available sources and obtaining information from open sources; desk research and face-to-face interviews (the team of experts visited each hromada, together with local finance advisors from Local Self-Government Development Centres, and conducted comprehensive surveys involving mayors, staff of financial and economic departments, others related staff, and reviewed financial and budget documentation); and production of specific reports for each hromada. The final stage involved presentations of the assessment findings and results to the management and executive bodies of hromadas, followed by discussions of the ways to improve local financial management. Each participating hromada received a detailed report containing findings and a matrix of recommendations grouped by implementation phases – for short-term, medium-term, and long-term perspectives. U-LEAD with Europe and its regional offices are committed to providing follow-up support to help implement these recommendations.

The assessment is not just a purely descriptive exercise. It is also a tool for future macro-level studies of financial management systems in hromadas. Thus, responses to questions in the desk research and questionnaires completed during face-to-face interviews can be used to construct AHs' ranking based on their performance in financial management and in each thematic field that was analysed. It will help identify the biggest challenges faced by local governments that require more support, including capacity building, advice or even legislative changes, depending on underlying causes.

## 2. OVERVIEW OF ASSESSED AMALGAMATED HROMADAS

This section reviews the information relevant for the assessment of public financial management (PFM) systems and processes in amalgamated hromadas (AHs), including but not limited to AH composition, institutional network, infrastructure, and key socio-economic indicators that may influence revenues and expenditures, hromada performance and local economic development. Attention was given to demographics indicators and their changes, availability of gender differentiated statistics, locally registered businesses, completeness of data in local registries, etc. The data collected was also used as the basis for findings elsewhere in the report.

### SUMMARY FINDINGS

1. The PFM assessment was conducted in 15 AHs from 10 oblasts (Vinnytsia, Volyn, Dnipropetrovsk, Donetsk, Ivano-Frankivsk, Luhansk, Odesa, Mykolaiv, Kirovohrad and Rivne) in the period June - December 2019. The assessment relied on data for 2018 and the first half of 2019. All assessed AHs were established in the period 2015-2017. They vary by population, ranging from 3,500 to 20,600 residents, and territory size, ranging from 63.5 to 669.0 km<sup>2</sup>, and have different administrative status (village, settlements, town council) with different distances from the closest city of oblast significance (COS) (see Table 1).

**Table 1.**

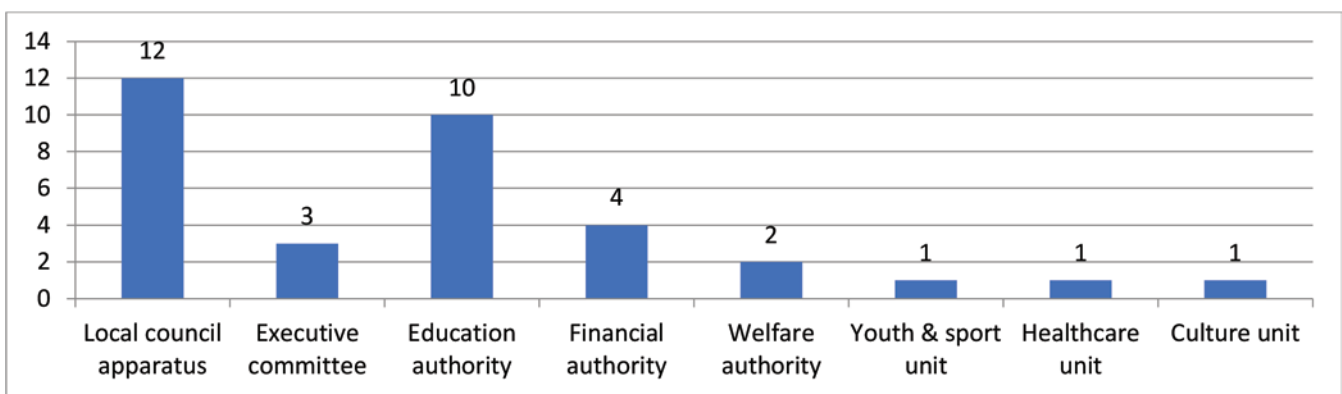
**AHs participating in Phase II of PFM Assessment Project**

| Oblast          | AH               | Type of council | Area, km <sup>2</sup> | Population, thousand residents | Distance between AH admin centre to COS, km |
|-----------------|------------------|-----------------|-----------------------|--------------------------------|---|
| Dnipropetrovsk  | Raivka           | village         | 669,4                 | 11,1                           | 44  |
| Vinnytsia       | Nemyriv          | town            | 271,4                 | 15,4                           | 46  |
| Mykolaiv        | Voskresenske     | settlement      | 192,4                 | 11,2                           | 16  |
| Luhansk         | Novopskov        | settlement      | 271,3                 | 12,2                           | 95  |
| Donetsk         | Soledar          | town            | 558,3                 | 20,9                           | 61  |
| Dnipropetrovsk  | Sviatovasylivka  | village         | 231,9                 | 4,3                            | 70  |
| Volyn           | Dubove           | village         | 125,0                 | 3,6                            | 75  |
| Donetsk         | Illinivka        | village         | 526,5                 | 9,6                            | 37  |
| Kirovohrad      | Sokolivske       | village         | 228,4                 | 6,1                            | 10  |
| Ivano-Frankivsk | Voynyliv         | settlement      | 77,1                  | 6,5                            | 40  |
| Kirovohrad      | Velyka Severynka | village         | 139,0                 | 3,5                            | 13  |
| Rivne           | Mala Liubasha    | village         | 414,4                 | 5,8                            | 37  |
| Luhansk         | Chmyrivka        | village         | 206,2                 | 6,7                            | 63  |
| Odesa           | Yasky            | village         | 225,3                 | 8,5                            | 58  |
| Rivne           | Klevan           | settlement      | 63,6                  | 11,7                           | 23  |

2. All of the assessed local governments have municipal institutions and companies on their books. Their financing structure depends on the scope of responsibilities taken. Generally, not all hromadas assume the full range of expenditure responsibilities defined in the Budget Code immediately after amalgamation. Indeed, whereas some hromadas took over all budget-funded institutions located within their boundaries from the start, others did so only partially

and selectively, and some even opted out of running budget-funded institutions, preferring former arrangements with corresponding transfers going to rayons. The latter option is not a good practice since citizens do not see that voluntary amalgamation makes any difference. Essentially, leadership of such hromadas refuse to take not only financial, but also managerial and even political autonomy.

3. All budget expenditures are carried out through budget programmes of the AHs' key spending units. The assessed hromadas have from one to six key spending units. Five hromadas have only one key spending unit, another five hromadas have two, and Soledar AH has six key spending units (Figure 1). It should be noted that designating a council's executive committee as a key spending unit constitutes a breach of Article 22 of the Budget Code, since it is a collegial governing body without legal personality. Because this problem is observed in three of the 15 assessed hromadas, it can be viewed as a systemic issue and therefore the reasons for such a set-up require further research from the side of AH leaders and government.



**Figure 1. Key spending units functioning in assessed AH**

4. Analysis of medium-term and strategic documents of the assessed hromadas finds that the most commonly-defined development priorities are the following:

- Ensuring proper functioning of schools, cultural institutions, and healthcare facilities,
- Ensuring quality of provision of administrative services,
- Development of local infrastructure and public amenities,
- Creating conditions for business development and investment mobilisation,
- Implementation of energy efficiency solutions and rational use of energy,
- Ensuring the rights and interests of children, creation of best conditions for their lives and development,
- Rational use of budget funds,
- Increasing public and civic engagement, and promotion of social cohesion, and
- Building a safe environment

Thus, hromadas' biggest concerns are around social issues, and they are prioritised in the medium-term and long-term perspective. At the same time, not enough focus is given to creating a conducive business environment, environmental protection in hromadas and energy efficiency. Sometimes, "execution of local budget" is formulated as a strategic priority, when it is essentially an operational function. This indicates a lack of understanding of what constitutes a strategy, development priority and causality, or a lack of true strategic vision, with full focus on tackling operational challenges accumulated during previous years.

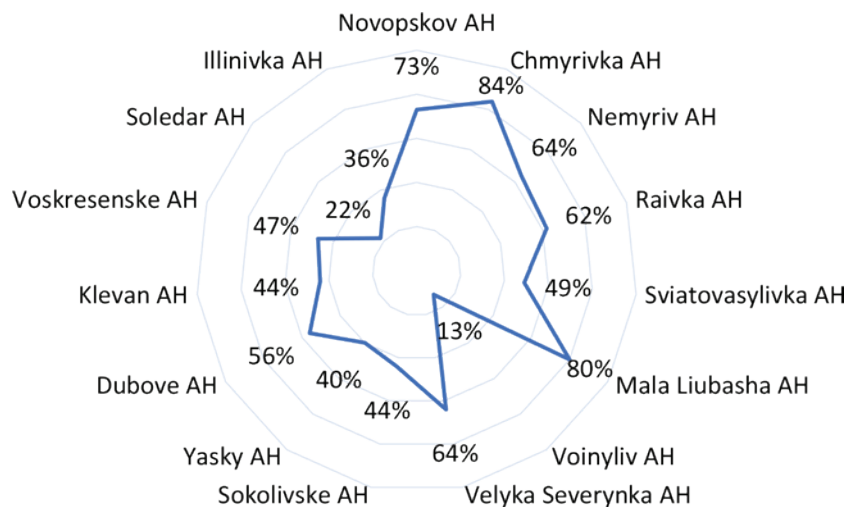


5. The extent to which documents and data held by local councils are made available to the public on official websites of local governments is generally not very satisfactory (Figure 2).



**Figure 2. AH that publish general information on AH on their websites**

Only six local governments publish their hromada passports online, seven local governments publish information about the network of institutions and organisations, but none offers information about sources used to calculate indicators of socio-economic development (e.g. demographic registries, municipal property databases, spatial databases, land registries, construction and development plans, etc), often because they simply do not exist.



**Figure 3. Summary findings of completeness of information about AH and its publication**



The assessment methodology gives the possibility to structure the assessment findings and compare hromadas using scores for each of the assessed areas. Completeness of information about hromadas and its availability is shown in Figure 3 above, displaying considerable differences between hromadas against selected parameters.

In AHs, the registers that should be used to calculate socio-economic development indicators (in particular, demographic registers, municipal property registers, spatial registers, land resource registers, development plans, etc.) are not made public. The reason for such issue is the absence of respective local registers.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Develop and publish a social passport that includes full information about the total population structure based on age, gender and ethnicity, information about gender breakdown in each of the hromada's settlements, details about employment and unemployment to the extent possible, and statistics about different types of companies,
- Designate a dedicated section on the hromada website to post information about key indicators of socio-economic development,
- For small village hromadas, consider possibilities to expand by merging with neighbouring hromadas to increase their financial, human and institutional capacity, thus strengthening their prospects for sustainable development and enabling them to deliver better services to citizens,
- Consider the possibility to create in hromadas own registries and databases (if lacking) that would enable better management of property and control payment of taxes into local budget, and
- Hromadas who defined council, a collegial body, as a key spending unit, should align the list of key spending units in compliance with the Article 22 of the Budget Code.

### For central government:

- It is necessary to review the form, structure and frequency of publication of statistical data generated by the State Statistics Service that present the demographic situation and affect hromadas' performance. According to AH representatives, they currently do not have sufficient statistical information about population by age, share of employable population, etc. It would be useful to develop a standardised data collection form that consolidates data gathered in different hromadas and shares the information automatically among local self-government bodies.

### 3. ORGANISATIONAL STRUCTURE OF AMALGAMATED HROMADAS

This section focuses on the analysis of the organisational structure of councils' apparatus and executive bodies, as well as their interaction. The assessment reviewed job descriptions and regulations on organisational units, noting overlaps and issues in distribution of responsibilities. Activity of local financial authorities, workload on staff in councils' executive bodies, and share of expenditures on administrative in total expenditure structure were also reviewed. The assessment also covered the extent to which expenditure responsibilities defined by the Budget Code are supported with financing, as well as the activity of the council as a representative body.

#### SUMMARY FINDINGS

► The study revealed that administrative structure of the assessed AHs is typical, with the variations only in the number of staff and organisational units (depends on the size of municipality and its needs).

As figure 1 showed, just four AHs have financial departments as separate legal entities. At the same time by the decisions of the sessions, they are determined as key spending units, that are responsible for: organising and coordinating the budgetary process, monitoring and review of budget execution, analysis of effectiveness of public spending and development of measures to increase budget revenues. For the rest, the financial unit forms part of the council's apparatus (executive body), which is typical of small village AHs

The advantage of separate financial departments as separate legal entities is that they are vested with a larger mandate, including the possibility to perform control functions, develop and approve regulations within their competency, perform audit of proper and effective use of budget funds, review salary calculations and perform ad hoc checks in institutions that receive financing from the budget. They may also be appointed as key spending units and implement a number of budgetary programs. This is especially important in the context of fiscal decentralisation considering high risks of inefficient spending of budget resources and poor internal financial controls in hromadas. At the same time, it should be up to each AH authority, especially in small village AHs, to decide on the economic expediency of setting up a separate financial department (unit) and allocating resources for its operation.

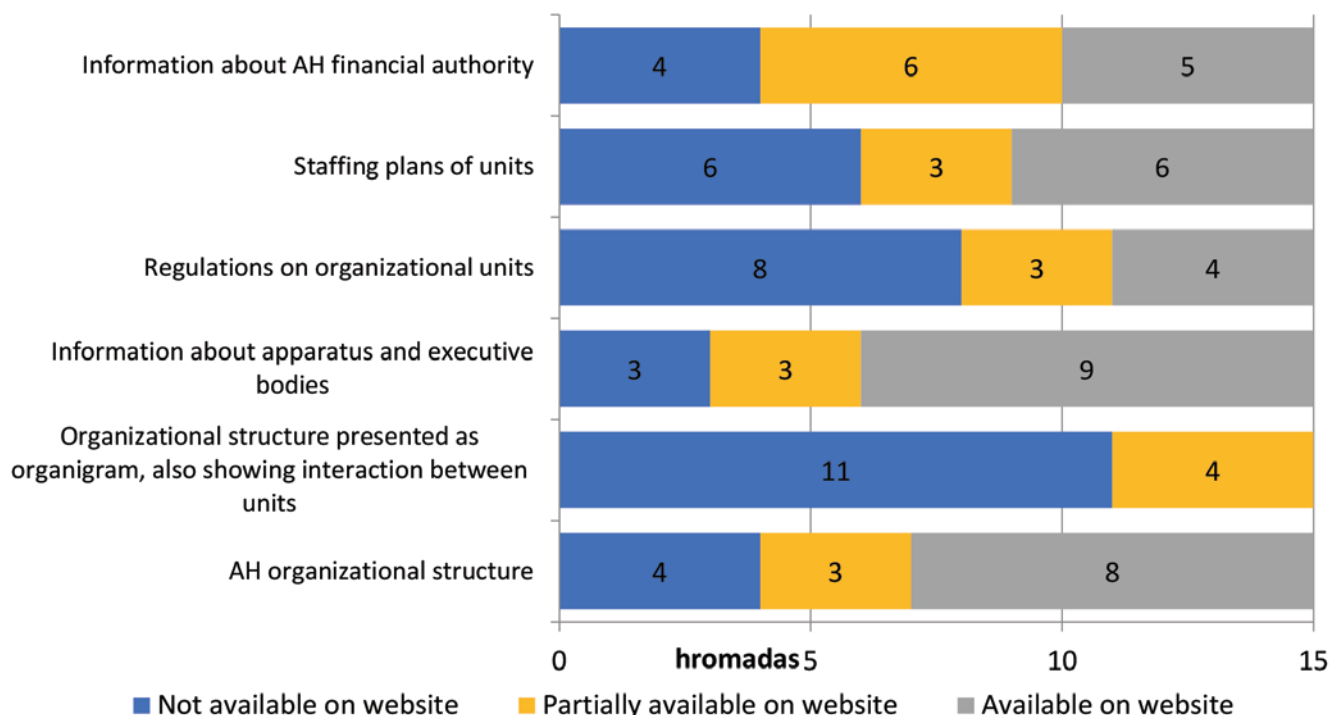
► Generally, after amalgamation the assessed hromadas were rather prompt in establishing necessary management structures and procedures. However, as reported by AH representatives (recorded in written questionnaires), they are still lacking highly professional staff in order to build effective financial management, rapid response to problems emerging from changes in the mode of functioning as an amalgamated local self-government or due to the volatility of national legislation. Administrative staff predominantly deal with routine work and face a large range of operational tasks.

► Regarding the structure of the administrative apparatus and executive bodies, the assessed AHs displayed a lack of streamlining, probably caused by the fact that typical regulations on structure and size of organisational units in local governments are of an advisory nature. On the one hand, this approach grants local governments discretion in decisions regarding the structure and size, taking into account specific conditions of each jurisdiction and scope of responsibilities. On the other hand, it may lead to lack of rationality in adopted arrangements which may inflate the costs of upkeep of administration in hromadas.

► In executive committees of some village councils, the council secretary performs the responsibility of executive committee secretary, which is stipulated by legislation. However,

some councils have both executive committee secretary and chief administrative officer which is essentially the same position. There are other inaccuracies in job titles, so communities should pay attention to application requirements of annexes 50-54 of Resolution of the Cabinet of Ministers of Ukraine of 09.03.2006 No. 268 on the structure and salaries of staff of apparatus of executive bodies, prosecution offices, courts and other authorities

► The reviewed regulations and job descriptions generally reveal no duplication among organisational units. They are approved according to legal requirements, but not all hromadas publish them on their official websites (see Figure 4), which is noted in recommendations.



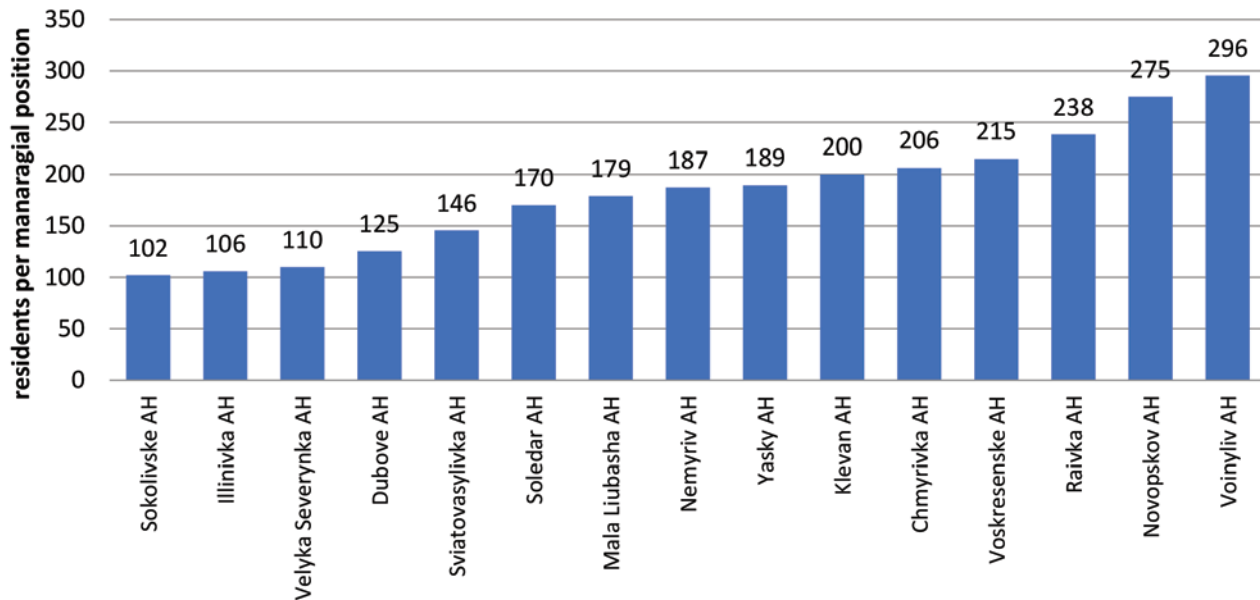
**Figure 4. Publication of information about the organisational structure**

As seen from Figure 4, the information about organisational structure is generally posted on official websites, but it is not always complete and may not be easy to find. For example, not a single website of the assessed hromadas contains a full organisational scheme, and almost 2/3 of the assessed hromadas have not published their full staffing lists. Besides that, the analyzed municipalities do not correctly present information about the administration structure on AH websites, whereby a general list includes both departments that are organisational units of the council apparatus and executive bodies that are separate legal entities. Also, not all hromadas provide regular updates with regard to changes in the structure and staffing plans, and some hromadas do not publish such information at all.

► Special attention was given to the education authority. In the majority of hromadas, the education department is set up as a legal entity (as per figure 1). In three hromadas, the education department also includes a methodology office, which considerably increases costs. This education management function could be organised more efficiently, for example, through inter-municipal cooperation or agreements with in-service training institutes for teachers. How well the education function is organised in hromadas has direct implications for hromadas' expenditures. Therefore, it is essential to optimise local school networks based on economic costing, and do not damage quality of education for pupils. Such optimisation

efforts (at various stages) were observed in eight hromadas, and the rest have not yet embarked on this process.

► Administrative workload in hromadas was calculated in order to assess expenditures on administration (Figure 5). Administrative workload may be judged as sufficient or excessive only in comparison with the population size.



**Figure 5. Administrative workload per 1 staffing unit of the LSG, residents per administrative position**

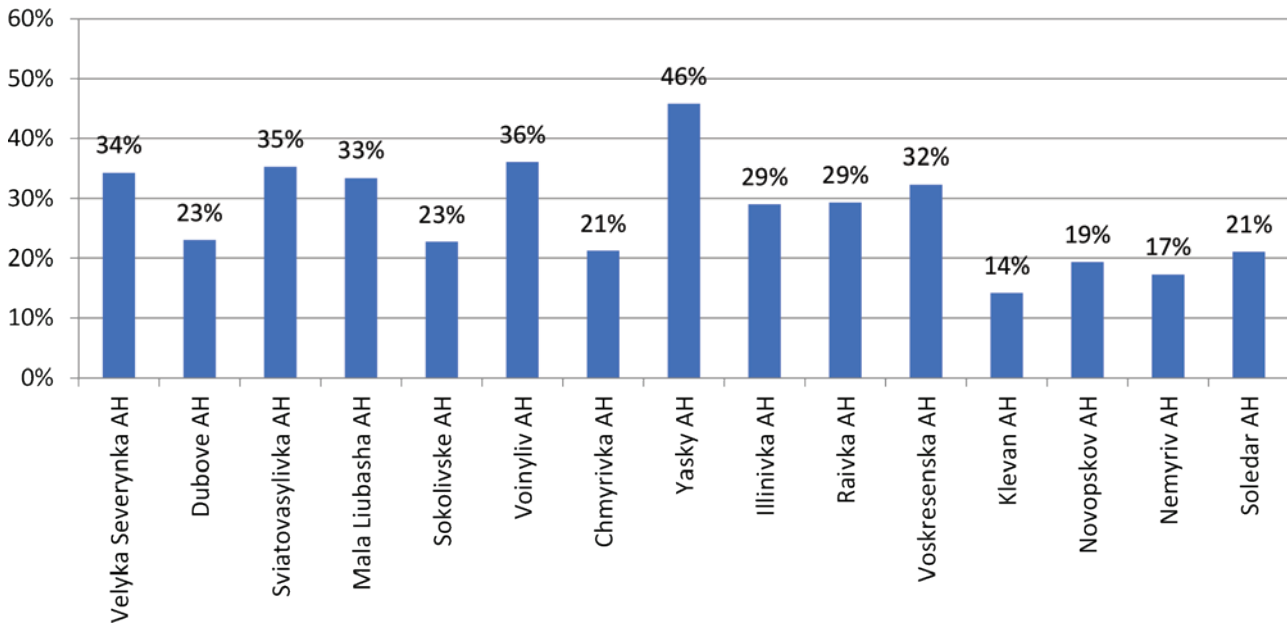
The diagram shows almost three times variation of average load on hromadas' administration – from 102 residents per administrative position in Sokolivske AH to 296 residents in Voinyliv AH (with average value across the assessed hromadas of about 200 residents per administrative position). While AHs with smaller populations might need more administrative staff due to the minimum staffing requirements of running a local self-government body, it should be noted that the population size of both hromadas is practically the same (6,500 people in Voinyliv AH and 6,100 people in Sokolivske AH).

The analysis of expenditures for executive bodies in relation to AH own revenues (without transfers) in 2018 revealed that the share of such expenditures varies considerably and, in some AHs, goes up to 46% (in Yasky AH) (see Figure 6). The lowest shares of such expenditures are found in Klevan, Nemyriv and Novopskov AH that spend 20% of own revenues on local administration.

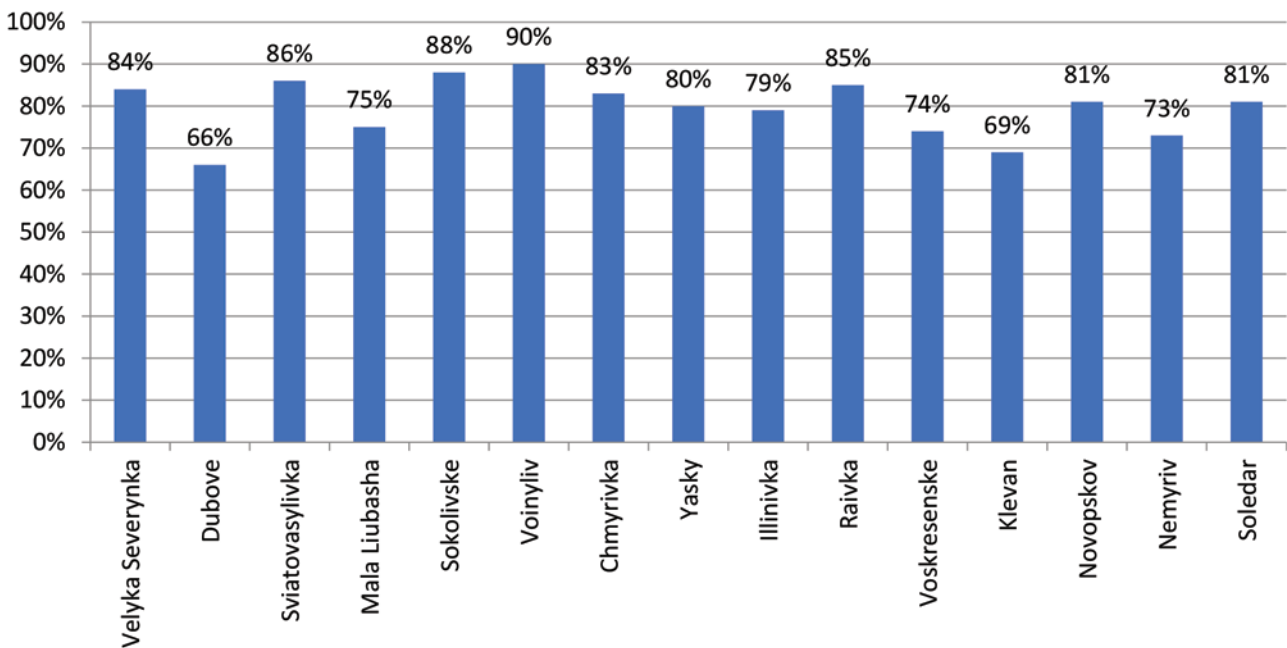
In the structure of administrative expenditures of the assessed hromadas, the largest share is taken up by labour costs (Figure 7), on average constituting 80% – from 66% in Dubove AH to 90% in Voinyliv AH.

► The analysis of the scope of responsibilities and functions envisaged for AH yielded the following findings:

- ♦ Only one of the assessed hromadas transfers its education grant to rayon level.
- ♦ Social services, pre-schools and the local archive of employees are predominantly financed through transfer of grants to rayons.
- ♦ Secondary healthcare is also frequently financed through transfer of grants to rayons.
- ♦ Five hromadas are founders of municipal not-for-profit primary healthcare facilities.



**Figure 6. Relation between administrative expenditures for executive bodies and AH own revenues (without transfers), % (ranked by the number of citizens – from smallest to largest)**

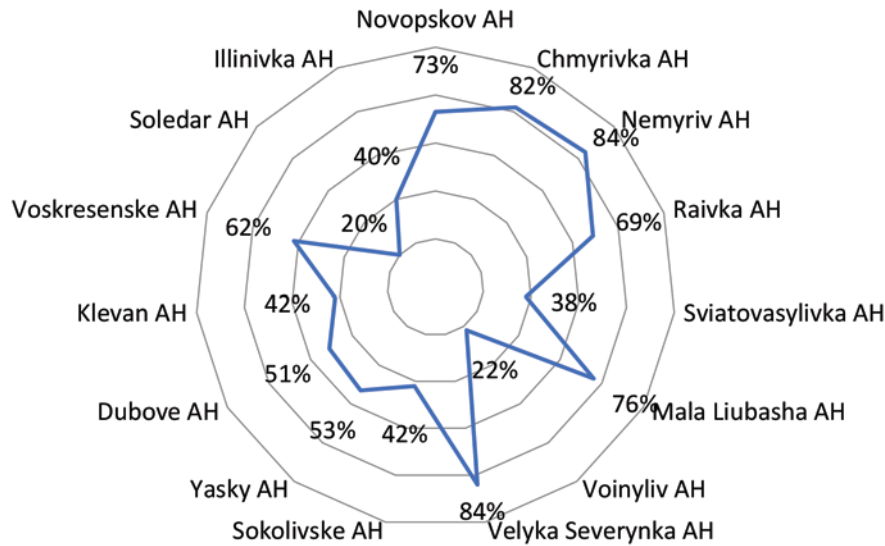


**Figure 7. Share of administration-related labour costs in total administrative expenditures, % (ranked by the number of citizens – from smallest to largest)**

Other responsibilities are financed according to the requirements defined in Article 89 of the Budget Code.

► Total scores received by the assessed hromadas from surveys and analysis in the section on organisation structure are shown in Figure 8.

Even though some hromadas scored more than 80% on the assessment scale in this area (Figure 8), organisational structure is still one of the most challenging issues. The main reason is absence of central regulations and a common methodology for calculating required institutional and organisational capacity that could help hromadas estimate:



**Figure 8. Total scores on organisational structure**

- Minimum efficient size of each organisational unit;
- Limits of administrative load and, respectively, total number of LSG officials that would enable best performance of assigned functions; and
- Number and size of organisational units in relation to the number of beneficiaries of public services, range of functions and levels of financing.

Responsibilities that are entirely new for village and rural hromadas (with no such experience before amalgamation) require a competent workforce and streamlined management structures. Not all hromadas successfully meet this challenge, again highlighting weak capacity in village and some rural hromadas.

## SUMMARY RECOMMENDATIONS

### For hromadas:

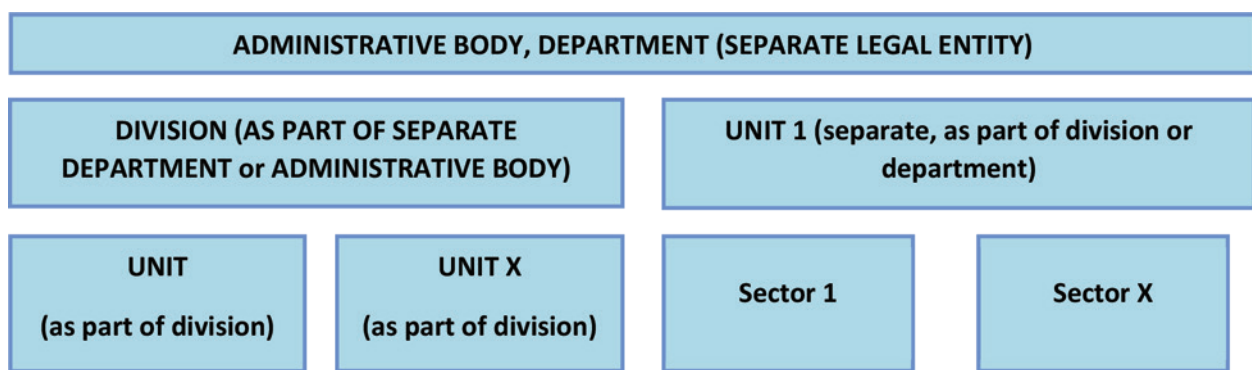
- Introduce in the municipalities the practice of calculating and estimating administrative workload and analysing its dynamics. The assessment showed that in the 15 analyzed AHs there is a significant variation in the administrative workload per 1 administrative position per 1,000 population and in the expenditures of municipalities on the administrative staff, which indicates that there are reserves for their optimization. But for more thorough conclusions, it is important to analyze the experience of neighboring similar AHs with a similar population and compare with each other, as well as take into account other factors that may affect this.
  - Publish up-to-date documents on official websites concerning the structure, staffing, and activity of executive bodies, approved rules of procedure of local councils.
  - Align position titles with the respective regulation.
  - Adjust the composition of executive committees to comply with the Law on Local Self-Government in Ukraine.
  - Consider the possibility to create separate legal entities – financial authorities and education authorities - where they do not have such legal status.
  - Consider the possibility to optimise the structure and staffing plan of administrative apparatus on the basis of monitoring of its load (where necessary).



- Consider the possibility to optimise expenditures for methodological services in education, e.g. through inter-municipal cooperation (where necessary).

**For central government:**

- Develop guidance on an optimal hromada structure for executive bodies in local self-governments taking into consideration: 1) population size of the hromada; 2) the set of functions and responsibilities performed by local self-government on a given territory. This requires setting the standards (minimum and maximum) for administrative load per optimal local self-government position in particular areas of sectoral administration. Such guidelines should not be mandatory, but rather each AH should make a decision on its application based on its own specific circumstances.
- Institutionalise the relations between organisational units of executive bodies by recommending to use clear hierarchical approach, for example as shown in Figure 9.



**Figure 9. Subordination of structural units within executive bodies**

This institutionalisation would be helpful for optimisation of scattered and misaligned structures within local self-governments. Currently, we have situations when heads of divisions manage individual employees rather than sections, which means that it is not a division but section, and the division is not structured by sections, sections by sectors, etc., and hence, there is no clear hierarchy, thereby creating a risk of duplication, unclear assignment of functions and absence of responsible officials.



## 4. TRANSPARENCY AND OPENNESS OF BUDGETS IN AMALGAMATED HROMADAS

This section focuses on the assessment of openness and transparency of budgets and the budgetary process in hromadas. It was done through monitoring of information on hromadas' websites, looking at their user-friendliness, the relevance and meaningfulness of information posted, and compliance with legal requirements. The emphasis was placed on completeness and convenience of published information about the budget and budget-related issues. Analysis of government-citizens interaction was performed in terms of citizens' engagement in the budgetary process, use of participatory budgeting, hromada promotion tools and dissemination of information about hromadas, as well as internet access for citizens and administrative institutions.

### SUMMARY FINDINGS

► All assessed hromadas (with the exception of Voinyliv AH) have an official website. They also use such social media as Facebook. However, the websites vary significantly in terms of structure, posted information, relevance and user-friendliness.

In the majority of cases, websites have separate sections such as budget, participatory budget, development strategy, local taxes and charges, etc., but the posted information can also vary.

**GOOD PRACTICE.** In January to September 2019, Novopskov Village Council participated in the "Budget Scanner" project. The full title of the project is "Budget Scanner or Implementation of a Standard Procedure of Mandatory Public Reporting of Key Spending Units" and it was implemented by the NGO "Institute for Social and Economic Research" as part of the civic engagement promotion programme "Join Up!" funded by USAID and implemented by PACT in Ukraine. **The project involved an outreach campaign to promote citizens' awareness of budgetary processes.** This information is posted in the news section. After implementation of the Budget Scanner, a dedicated section was created on the website. Executive Committee of Novopskov Village Council adopted Decision No. 9/128 of 17.05.2019 by which it approved the procedure for public reporting about execution of its budget.

► Legal requirements include the obligation to:

- ♦ publish local council decisions approving (or amending) the budget with all annexes, and budget execution reports. It is advised to produce visualisation to make information more accessible for ordinary citizens.
- ♦ publish budget programme passports and corresponding performance reports, as well as forecast indicators.

Regretfully, this information is not always available on hromadas' websites. It is often the case that decisions about adopting or amending a budget are not in dedicated sections but in the 'decisions archive'. It means that, in order to find this information, one has to know the exact date and number of a decision, which complicates the search effort.

► Websites of the assessed hromadas contain links to external resources with available information about hromadas, budgets, procurements, spending and key spending units, such as ProZorro, Paywatch, E-Data, OpenBuget, etc.

The websites of 10 hromadas include the option for citizens to leave their comments and suggestions through sections on electronic petitions, communication addressed to the mayor, or other means.

Formal procedures for collection of citizens' proposals have not been put in place in all hromadas. Public consultations are also non-standardised and need to be more active, by involving more citizens and local council members as well as more active position of starostas. Using electronic form of consultations is already introduced in some AHs, but it is not a common practice (as it all depends on the needs of AHs' citizens).

▶ On the positive side, 10 hromadas have participatory budget programmes and two hromadas have budget visualisation. The websites of Novopskov AH and Chmyrivka AH provide video-recording of council sessions and such a practice encourages citizens' engagement in the budgetary process.

Novopskov AH and Chmyrivka AH adopted a budget regulation that serves as basis for the budgetary process and includes procedures and timelines for budget drafting, approval, organisation of its execution and defines key actors in this process, including citizens. It regulates activity of entities engaged in budgetary relations at all stages of budget drafting and adoption.

▶ Internet coverage is available to the whole territories of assessed hromadas, and hence citizens could establish internet connection if they want. Thus, the potential for implementing an open budgetary process in AHs is available.

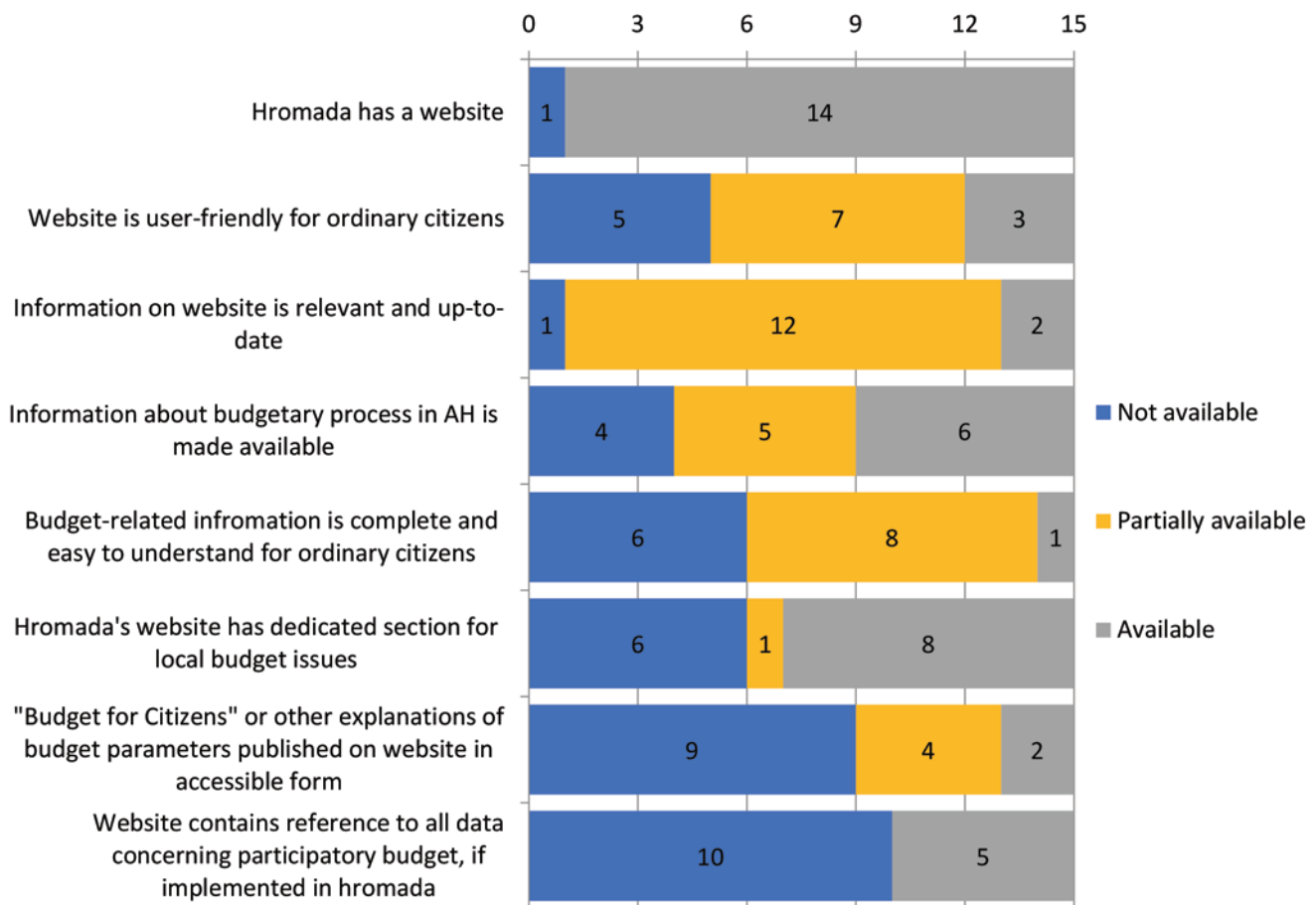
▶ The summarised findings on transparency and openness of budget and budgetary process in hromadas are presented in Figure 10.

**GOOD PRACTICE.**

Chmyrivka AH publishes minutes of its permanent committee on budget, finance and socio-economic development, the local self-government's administrative budget, budget requests, etc. Especially noteworthy is the section "Budget for Citizens" that presents accessible and easy to understand information (infographics) both on revenues and expenditures. Printed copies of the document are available at the village council, starosta's offices and schools (secondary schools and kindergartens).

**GOOD PRACTICE.**

The website of Velyka Severynka AH contains a section "Report of Velyka Severynka Mayor on the Work in 2018", with information about hromada's budget broken down by starosta districts.



**Figure 10. Summarised findings on transparency and budget / budgetary process openness**

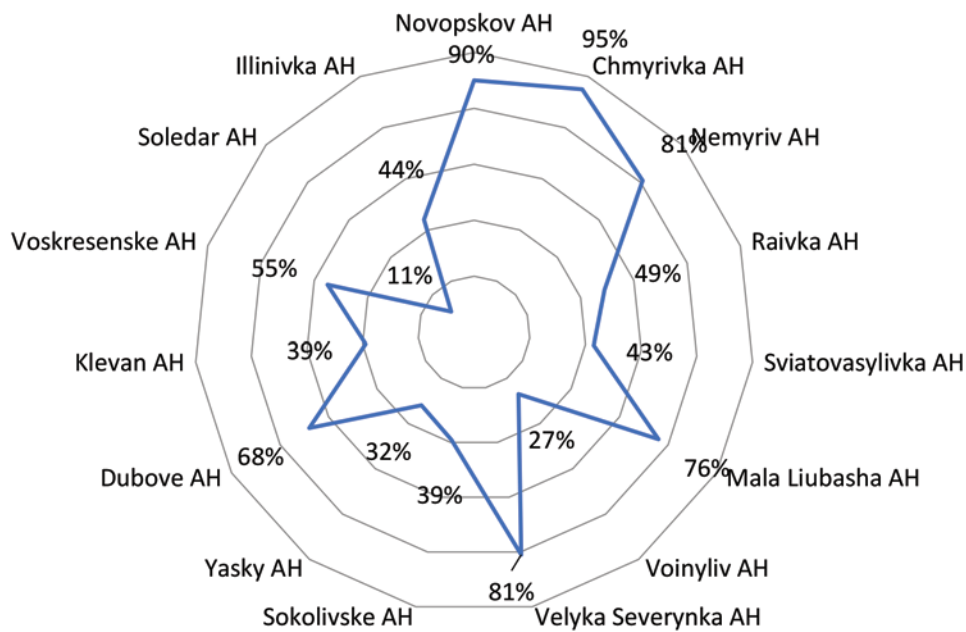
The data in Figure 10 and results of the analysis show that specialists in the assessed hromadas

understand the importance of open public activity tools and publish a lot of information on their websites, as a way to make the budgetary process more transparent and open for the public.

At the same time, this work should be continued and even stepped up. In some hromadas, leaders do not pay enough attention to visibility and transparency, not only in relation to budgeting, but also when it comes to governance and public administration actions.

Budgetary information on websites often needs updating. It also has to be made more accessible for citizens. For example, reports about evaluation of effectiveness of budget programmes are nowhere to be found on websites of the assessed hromadas.

► Total scores received by the assessed hromadas from surveys and analysis in the section on budget transparency and openness are shown in Figure 11.



**Figure 11. Total scores on budget transparency and openness**

According to the total scores on transparency and openness, the highest results were shown by Chmyrivka AH (95%), Novopskov AH (90%), Nemyriv AH (81%), and Velyka Severynka AH (81%). On the other hand, Illinivka AH and other hromadas should give more attention to transparency of their budgetary processes, since 9 out of 15 hromadas scored below 60%. This emphasises the need both to enhance the dialogue with citizens in the budgetary process and to present more complete and relevant information about the budget and its implementation on local governments' official websites.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Regularly present budget-related information and budget indicators on official websites.
- Comply with mandatory requirements, stipulated in the budget legislation, for online publication of budget requests and assessment results of effectiveness of all budget programmes.
- Design a clear procedure and regulate collection of citizens' proposals during budget drafting, thus making the mechanism of public engagement in the budgetary process transparent and known to citizens in advance, and publish a report concerning these proposals when drafting the budget

for the upcoming year, highlighting those that were accepted and those that were rejected with reasoning.

- Make an effort to publish budget-related information in an accessible and easy to understand form, preferably before the adoption of a budget, and when it is adopted, provide explanations on key points of the budget and amendments made during the year, and visualise data from quarterly and annual reports on budget execution.
- Introduce and regulate the practice of public consultations to discuss draft decisions on local taxes and charges, including in electronic form which will help the consultations to reach and involve more young people.
- Conduct training and consultations on budget topics for local council members, starostas, and youth councils, and engage them in budget-related outreach activities with the public.

## 5. STRATEGIC PLANNING AND READINESS FOR IMPLEMENTATION OF MEDIUM-TERM BUDGETING

This section is dedicated to the analysis of organisation of strategic and mid-term planning in hromadas. The starting point was to establish whether hromadas have socio-economic development strategies and plans of socio-economic development, and then the extent to which they are applicable, coherent, and considered in the budgetary process. Another aspect was to look into challenges that arise during drafting and approval of hromadas' budgets and consistency of actions among individual units in this process. Assessment was made of the planning of revenues and expenditures, deviation of actual budget execution from the initial plan, frequency of changes to the budget, and implementation of socio-economic development plans through annual budget.

### SUMMARY FINDINGS

► Socio-economic development strategies have been designed and approved in nine hromadas. These strategies are published on official websites in dedicated sections, together with implementation plans. The socio-economic development strategies were designed with participation and inputs from the public institutions and other organisations, businesses of all sizes active within the respective hromadas.

All hromadas have programmes for socio-economic development. In addition, they also adopt individual target programmes (their number in AHs varies from 13 to 28). At the same time, it is also quite common not to back the adopted target programmes with financing due to financial constraints, thus rendering them a mere formality with no produced outcomes in the absence of funding. In times of fiscal constraints, AHs need to prioritise their socio-economic development programmes and stagger implementation with the most urgent and important ones launched first.

Regretfully, it is still a common practice that socio-economic development strategies are only mentioned formally in the budget, but are not used in the budgetary process. Hromada leaders and managers were advised to give more attention to planning systems, bearing in mind that the socio-economic development strategy, programme of socio-economic development and local target programmes should be inputs to budget development and reflected in budget indicators. Furthermore, evaluation of budget programmes should enable management to determine the quality of services provided to citizens and the extent to which strategy goals and objectives have been achieved.

For all assessed hromadas, there is a need to make efforts to achieve mutual coherence between strategic planning, operational planning and financing of defined priorities. Not a single hromada has yet reached full balance in these issues. However, there are commendable examples in Nemyriv AH, Novopskov AH and Chmyrivka AH, where activities outlined in the socio-economic development strategies and programmes are related and backed with financing, but even here it would be too early to claim full alignment between strategic planning and budgeting, as the former should encompass all activities that the AH authority intends to take forward, while the budgeting should derive from strategy implementation and including workforce planning for the LSGB.

► The lack of a comprehensive approach to design measures aimed at developing and delivering high quality public services, effective socio-economic problem-solving, and achievement of sustainable growth, results in ongoing, sometimes chaotic, tweaking of hromada's budgets throughout the year. The frequency of such changes is quite high; for example, Nemyriv AH amended its budget 28 times in 2018 – 16 through council decisions and 12 through decisions of the executive committee. Such changes were partly necessitated in all assessed hromadas by institutional development (like the transfer of municipal property), but partly they were due to the lack of a comprehensive approach.



► The analysis of problems in the process of preparing and approving budgets found no unsolvable issues. There is sufficient interaction between organisational units of the council, executive committee, standing commissions and higher-level executive bodies.

The biggest operational challenges in organisation of the budgetary process are:

- absence of statistical information about the population by age groups and share of employable population;
- absence of payroll data for companies and institutions located on the territory of hromada, which complicates calculation of revenues;
- absence of information on taxes and fees within taxpayers, as well as instalments and write offs of their taxes and fees;
- incomplete information in hromada registries (demographic, land, municipal property databases) and lack of access to some national registries.

This is typical for all 15 hromadas covered by the assessment.

As a result, there is a significant deviation of actual budget execution (both revenues and expenditures) from the initial adopted budget. This deviation ranges from 20% to 39% in the assessed hromadas. For comparison, the international budgeting practice defines a precise budget as one with average deviation from targets of up to 5% (within the statistical margin of error). Thus, such a significant departure from the initially-adopted targets poses risks to the implementation of the annual budget, and for medium-term budgeting and its feasibility at the hromada level.

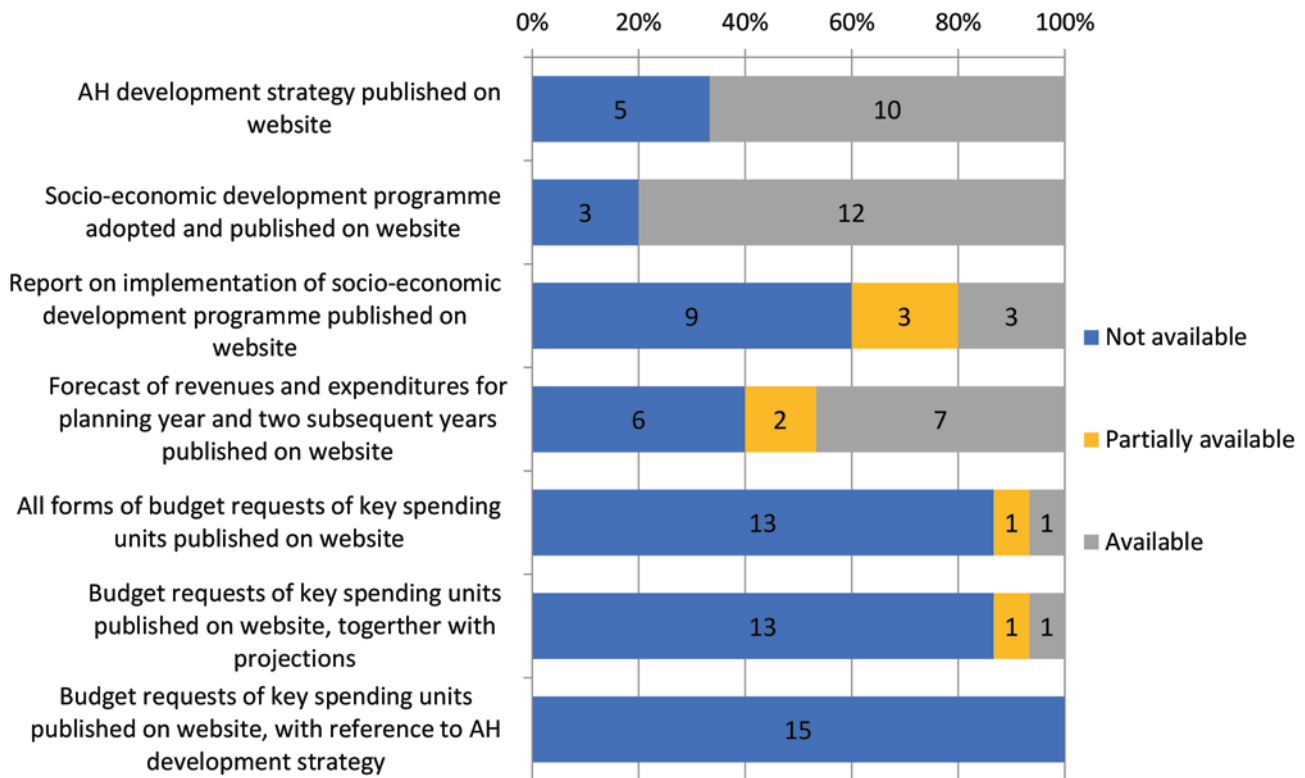
► The assessed hromadas are taking measures to be prepared for introduction of medium-term budgeting starting from 2021 (as medium-term budgeting will be applicable starting from 2020 budget year for preparation of the 2021 budget). Nonetheless, even in 2018, when preparing 2019 budget requests, key spending units made indicators for the planning period (draft budget for 2019) and two subsequent years (budget projections for 2020-2021), hromadas approved budget projections, key spending units were informed about expenditure limits, and guidelines on budget requests were approved. While this work has been carried out in 12 hromadas, all hromadas need further methodological support and advice in this process.

► As of today, preparation of local budget projections essentially relies on formal compliance with the provisions of budget legislation. Typically, revenue projections are not detailed and thus do not allow for robust prediction of all revenues for a particular hromada budget. Towards the end of 2018, the Budget Code was amended by establishing new rules for local budget projections to be applied from 1 January 2020. It is expected that it will become a tool for medium-term budgeting, defining medium-term indicators and serving as the basis for drafting of local budgets for medium-term period. This approach should enable local self-governments to follow a consistent budgetary policy, but to be fully operational, medium-term budgeting should first be implemented at national level. This will allow hromadas, when making projections, to take into consideration all budget revenues (including inter-budgetary transfers from the national budget) and prioritise spending in a medium-term perspective.

► Summarised findings on strategic planning and readiness to implement medium-term budgeting in hromadas are presented in Figure 12.

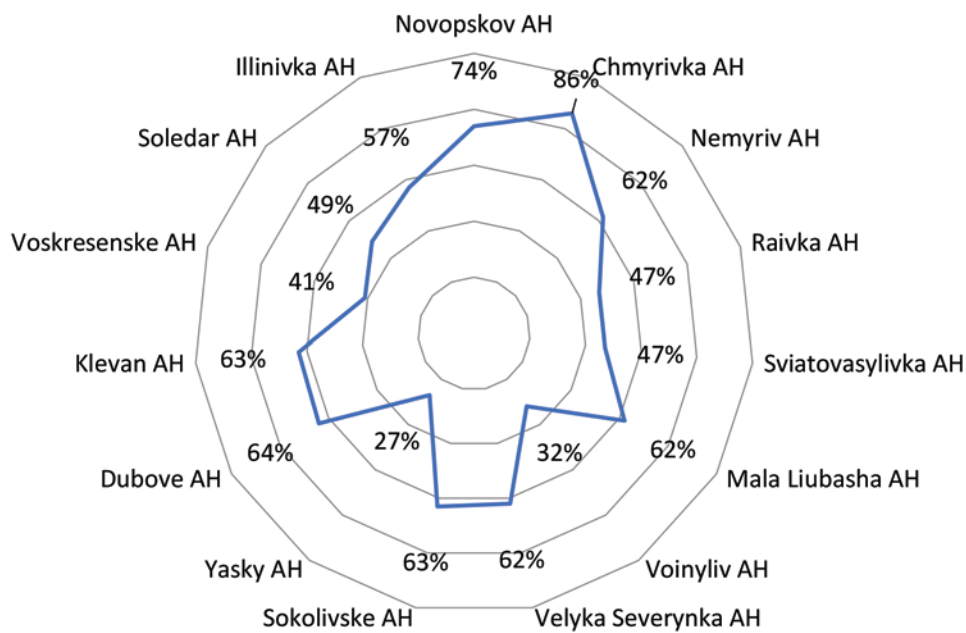
The assessment has revealed that none of the assessed hromadas publishes on its website budget requests of key spending units with reference to its socio-economic development strategy, which confirms the absence of sustainable and coherent strategic planning. Just six hromadas publish full or partial reports on implementation of socio-economic development programmes, whereas other hromadas do not have such reporting in place. Just seven hromadas make publicly available their projections of expenditures and revenues for the planning period and

two subsequent budget years, while two hromadas do it partially, which calls for improvements in this area.



**Figure 12. Summarised findings on strategic management and readiness to implement medium-term budgeting**

► Total scores received by the assessed hromadas in the section on strategic planning and readiness to implement medium-term budgeting are presented in Figure 13



**Figure 13. Total scores on strategic planning and readiness to implement medium-term budgeting**



As shown on the diagram, the strategic planning process is best organised in Chmyrivka AH (86%). At the other end of the spectrum, Yasky AH (27%) has no developed and approved strategy. On the whole, the scores highlight the need to improve strategic management in hromadas by building links between legitimate strategic goals and the budget both in terms of resources and outcomes.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Revise approaches to revenue and expenditure planning, using in-depth analysis of local budget execution in previous and current budget periods.
- Strive to align strategic planning and budgeting, and review the existing target programmes, ensuring their implementation by planning related yearly costs in hromadas' budgets.
- Update hromada's registries that could provide useful data for strategic and operational planning.

### For central government:

- To ensure the principle of unity of a budgetary system:
  - ◆ speed up the development of methodological guidelines and explanatory materials for implementation of medium-term budgeting concerning planning and forecasting of inter-budgetary transfers,
  - ◆ ensuring mutual coherence of medium-term budgeting rules and procedures at all levels,
  - ◆ using the medium-term budgeting instructions to develop and embed a comprehensive perspective on strategic planning and management in AHs, which takes into account of LSGBs' entire remit, not just development, and is linked to workforce planning and asset management.
- Provide access to national registries, improve exchange of information with tax authorities or give access to LSG bodies to necessary information about taxpayers of their territory.

## 6. BUDGET REVENUE MANAGEMENT IN ASSESSED HROMADAS

This section looks into the structure and dynamics of AH revenues, correlations between own revenues and transfers, and the levels of subsidies received by hromadas. The aspects explored included availability / unavailability of information (databases) on taxpayers by types of taxes, dependence on one or two taxpayers, and the problem of shadow employment and how hromadas tackle it. The analysis looked into factors that influence revenues like PIT, local taxes and charges, and other taxes in hromadas, and what actions are taken to maximise tax revenues without a heavy increase in the tax burden on law-abiding taxpayers and business. Separate attention was given to work with tax debtors in AHs, expansion of the tax base and attracting citizens who do business activity without registering as entrepreneurs, as well as organisation of cooperation with tax authorities.

### SUMMARY FINDINGS

► The assessed hromadas have most of their revenues concentrated in the general fund (Figure 14). In terms of revenues, the share of special fund in most hromadas does not exceed 4%. The largest shares of special fund were found in hromadas located in Donetsk and Luhansk oblasts, accounting for comparatively large amounts channelled towards restorative efforts in the region (the largest amounts were received by Novopskov AH in Luhansk oblast and Illinivka AH in Donetsk oblast).

All assessed hromadas planned for revenue growth in 2019 versus 2017 and 2018.

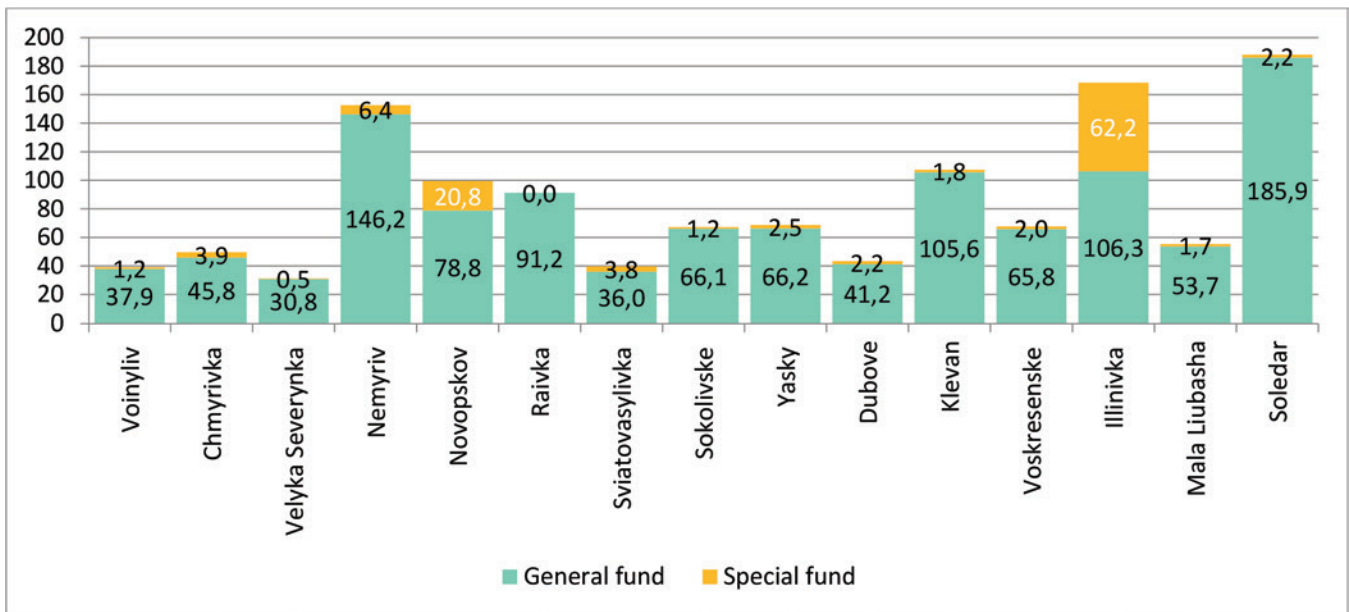
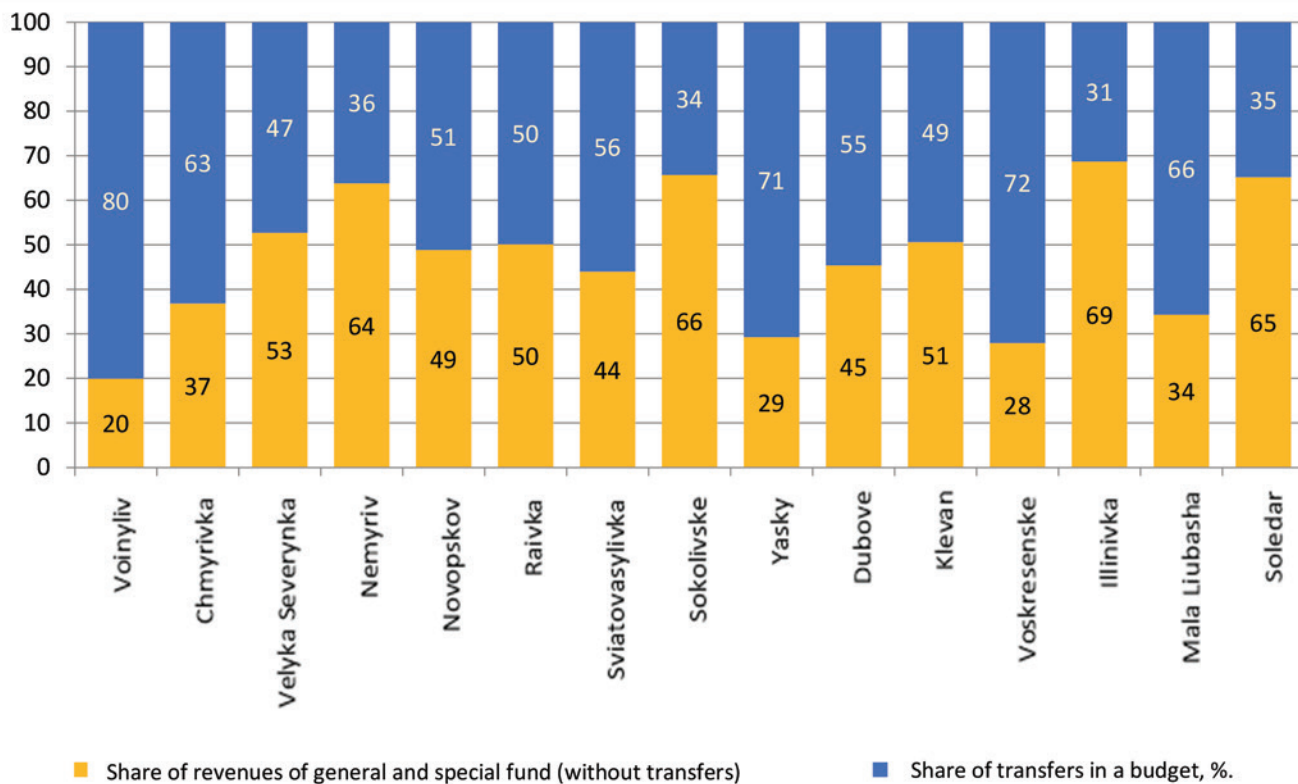


Figure 14. AH revenues by types of fund in 2018 (with transfers)<sup>1</sup>, million UAH<sup>2</sup>

In the assessed hromadas, transfers contribute between 31% and 80% of total hromada revenues (Figure 15).

<sup>1</sup> Seeking consistency of the annual analytical sample, the aggregated information in this report is presented for 2018.

<sup>2</sup> Soledar and Nemyriv are town AHs with 15-20 thousand citizens, Klevan, Raivka, Voskresenske, Novopskov are mostly settlement AHs with 11-12,2 thousand citizens, Illinivka, Yasky, Sokolivske, Voynyliv, Chmyrivka, Mala Liubasha are mostly village AHs with 5,8-9,6 thousand citizens, Sviatovasylivka, Dubove and Velyka Severynka are village AHs with less than 5 thousand citizens



**Figure 15. Relation between total AH revenues and official transfers to AHs budgets in 2018, %**

In eight of all assessed hromadas, transfers account for more than 50% of total revenues, including five hromadas where this share exceeds 60%. The greatest dependency on transfers from central budget can be found in Voinyliv AH (80%), Voskresenske AH (72%) and Yasky AH (71%). These hromadas receive the largest base grants (among the assessed hromadas), collect the lowest revenues from PIT and excise taxes, have low revenues from local taxes and charges, and their per capita revenue of the general fund ranges from UAH 1,100 to 2,000. Taken together, these factors make hromadas significantly dependent on transfers.

For comparison, Klevan AH and Raivka AH have similar population size as Voskresenske AH, and similar amounts of transfers, also being rural hromadas, but they are significantly less dependent on transfers which make up 32% and 46% of their budgets, respectively (Table 2). The main difference is in revenues from PIT and local taxes and charges: whereas Klevan AH mobilises high revenues and even pays the reverse grant, Raivka AH, having less capacity for PIT collection, does a better job with administration of local taxes and charges (collecting almost three times as much as Voskresenske AH in 2018).

In assessed hromadas, the largest share of official transfers is covered by the education grant (from 42% to 77% of all transfers) and the healthcare grant (from 13% to 34% of all transfers). These are targeted streams of national funding for key delegated responsibilities – quality education and healthcare services. Thus, on average 77% of transfers in the assessed hromadas are ear-marked (in some hromadas reaching 91% of transfers), which limits their autonomy in using these resources.

► In 2018 budget year, nine of the assessed hromadas received base grants and five paid reverse grants (Soledar, Dubove, Illinivka, Sokolivske, and Klevan). In four hromadas, the base grant equalled 36% to 66% of their general fund revenues, while in another four hromadas this did not

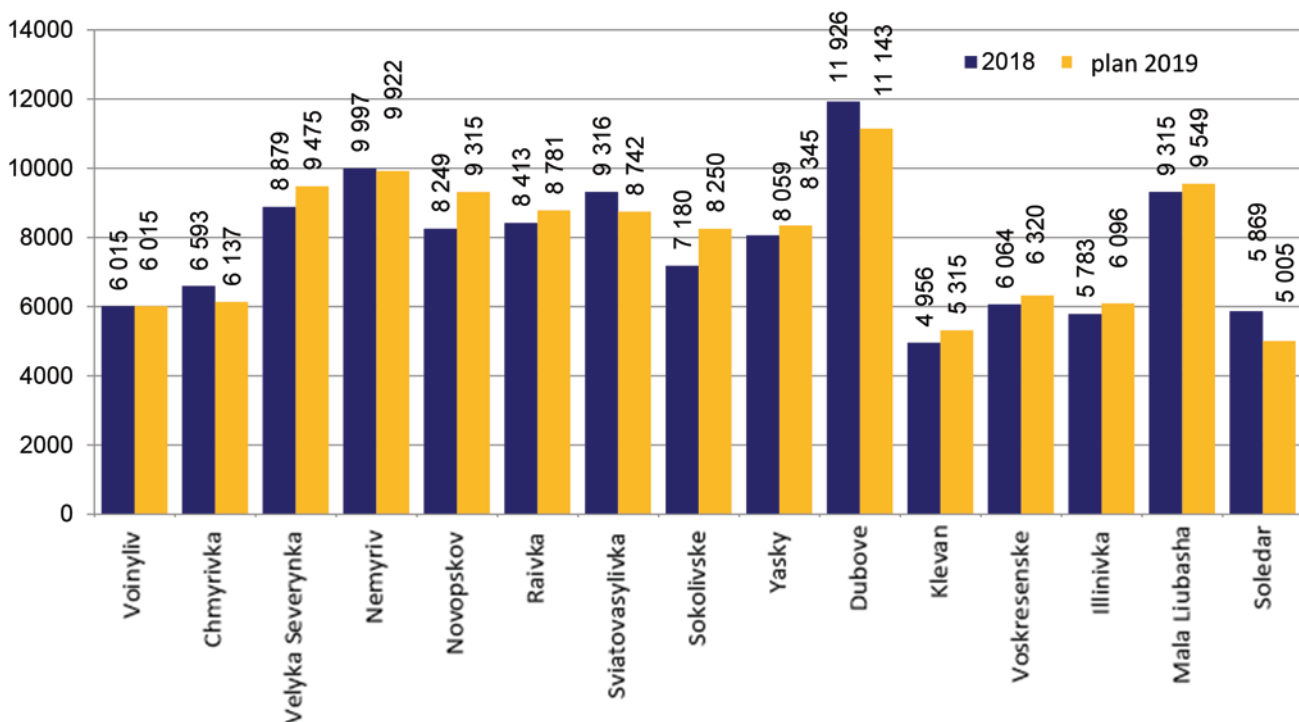
Table 2.

Revenues of some AH with comparable population but different shares of transfers,  
thousand UAH

| AH           | Population as of 01.01.2018 | Total revenues (general fund) | Including |                         |           |            | Total transfers | Including  |               |                 | Total revenues (general fund) with transfers | Per capita revenues | Share of transfers in AH revenues |
|--------------|-----------------------------|-------------------------------|-----------|-------------------------|-----------|------------|-----------------|------------|---------------|-----------------|--|---------------------|-----------------------------------|
|              |                             |                               | PIT       | Local taxes and charges | Land fees | Single tax |                 | Base grant | Reverse grant | Education grant |  |                     |                                   |
| Raivka       | 11073                       | 45870,6                       | 21646,1   | 22874,8                 | 9623,5    | 11949,8    | 39439,0         | 2814,1     | 0,0           | 20107,5         | 85309,6                                      | 4142,6              | <b>46%</b>                        |
| Voskresenske | 11168                       | 17475,4                       | 8310,1    | 8276,3                  | 2166,9    | 5659,6     | 38611,9         | 8754,7     | 0,0           | 16725,3         | 56087,3                                      | 1564,8              | <b>69%</b>                        |
| Klevan       | 11704                       | 68638,8                       | 55071,1   | 9262,9                  | 3021,2    | 5651,4     | 31758,9         | 0,0        | 5053,4        | 18601,5         | 100397,7                                     | 5864,6              | <b>32%</b>                        |

exceed 10%, suggesting that the latter have sufficient financial capacity and did not need much in terms of equalisation funding to enable them to perform their functions.

► The comparison of total per capita revenues (with transfers) revealed that Dubove AH and Velyka Severynka AH have the largest per capita revenues among the assessed hromadas (Figure 16), but they are also the smallest in terms of registered population (3,600 and 3,500 residents, respectively). In 2018, for example, the average per capita revenues in Ukraine was UAH 8,194.30, while per capita revenues of Dubove AH was almost 1.5 higher than the national average. This high value was largely due to comparably higher amounts of transfers versus other hromadas with larger population and more resources. That is why it is important to estimate per capita revenue without transfers, which would yield values that are more objective indicators of financial stability before their equalisation.



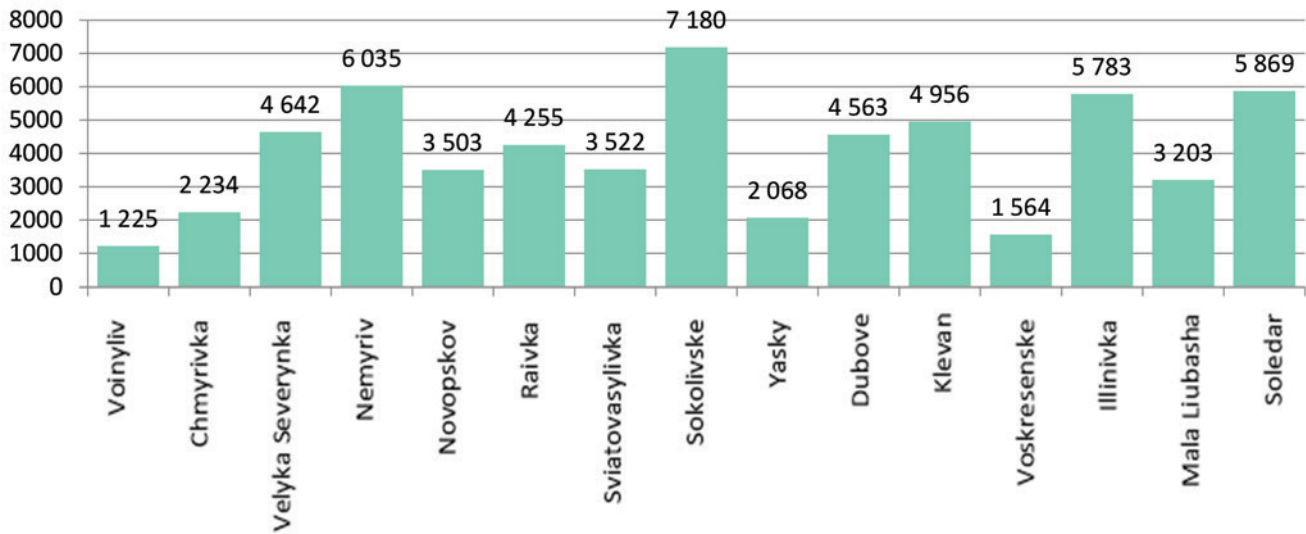
**Figure 16. Total per capita revenues in assessed AH in 2018 and 2019 targets, UAH**

At the same time, just nine hromadas in 2019 projected growth of total per capita revenues (according to targets). Voynyliv AH did not expect any growth even to set off the inflation, and the remaining five hromadas even expected their total per capita revenues to decline.

We would like to underline that Article 9 of the European Charter of Local Self-Government establishes that, as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.

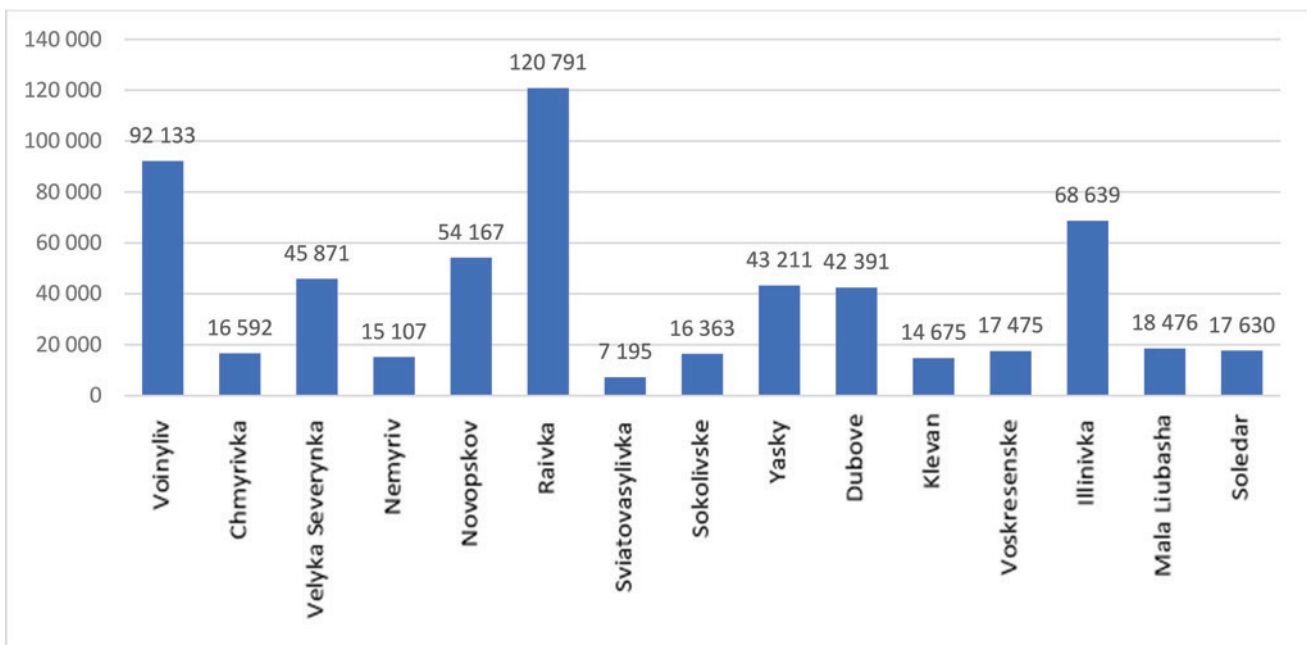
► Comparing per capita own revenues with the 2018 national average of UAH 3,978.4, the lowest are own revenues in Voynyliv AH, Voskresenske AH and Yasky AH, where per capita revenues of the general fund are 50% of the national average or even lower (Figure 17), due to low revenues from PIT and local taxes and charges. At the same time, Sokolivske AH, Soledar AH and Nemyriv AH have per capita own revenues that are 1.5 – 2 times higher than the national average. These are hromadas with high PIT revenues. Thus, PIT is the tax that has the highest influence on per capita revenues, and hence it is critical for hromadas to

promote the creation of businesses, that has employees in a staff, and registration it within their jurisdictions.



**Figure 17. Per capita own revenues in 2018, UAH**

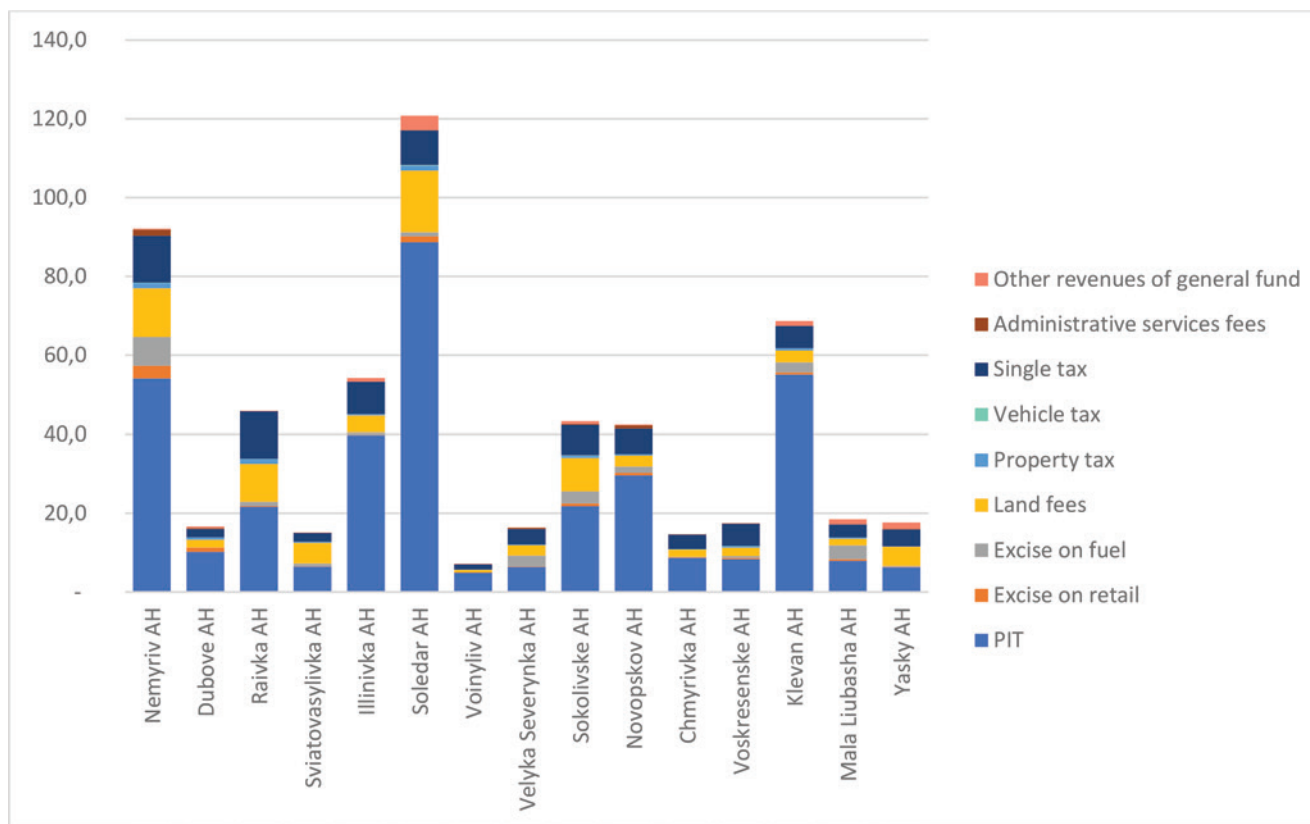
It is clear that the assessed hromadas have different capacities to generate own revenues (charges and fees, and other non-tax revenues), as shown in Figure 18. Nemyriv AH, Soledar AH, Klevan AH and Illinivka AH have the largest own revenues, and they also have one of the largest populations (their per capita own revenues are also higher than the national average, as seen from Figure 17). Generally, there is observed correlation between population size and own revenues in the assessed hromadas (coefficient of correlation is 0.77), which means that the larger population leads to larger own revenues (interdependence of these two values is 57%, with 43% dependence on influence of list of some other factors).



**Figure 18. AH own revenues in 2018, million UAH**



► The revenue structure in the assessed hromadas is typical for most AHs in Ukraine. In 2018, the largest revenue sources, excluding transfers, were PIT, land fees and single tax (Figure 19):



**Figure 19. Revenue structure of general fund in 2018, thousand UAH**

All hromadas collected zero revenues from parking fees. The collection of vehicle tax ranged from UAH 0 to 100,000. (so, there are up to four taxpayers that payed vehicle tax in an analysed year because generally this tax is collected once a year. So, the mechanism of accruing this tax must be revised and amendments to the Tax Code are needed). The assessed hromadas collected from UAH 76,000 to UAH 1,000,000 from property tax, other than land. There is certainly room for increasing revenues from this tax. However, this requires updating of property registries, establishment of property title, and revision of the mechanism for calculation and payment of property tax defined by legislation.

► The main revenue source for hromadas' general fund is PIT. Its share in AH own revenues varies from 36% in Yasky AH (with few registered legal entities that employ labour) to 80% in Klevan AH (see Figure 20). In three hromadas (Voskresenske, Velyka Severynka and Raivka), revenues received from PIT and from local taxes are almost the same.

The assessed hromadas have different levels of PIT revenue from employees of budget-funded institutions (reflected in budget expenditures for public sector salaries) in total PIT revenues, ranging from 7% in Klevan AH to 67% in Voinylyv AH (Table 3).

High level of dependence (over 40%) may indicate that hromada has few private sector operators. Typically, the public sector is the most reliable employer that regularly pays taxes, however, high dependence of local budgets on taxes paid by public sector employees suggests that hromada's economic situation is not good. Table 3 indicates a trend whereby higher PIT share from the public sector in the hromada's budget correlates with lower average per capita own revenues. In the



absence of other revenue sources, delivery of basic services to citizens will have to be covered by national transfers and equalisation grants, which are hardly enough to stimulate hromada's development in the medium and long-term perspective.

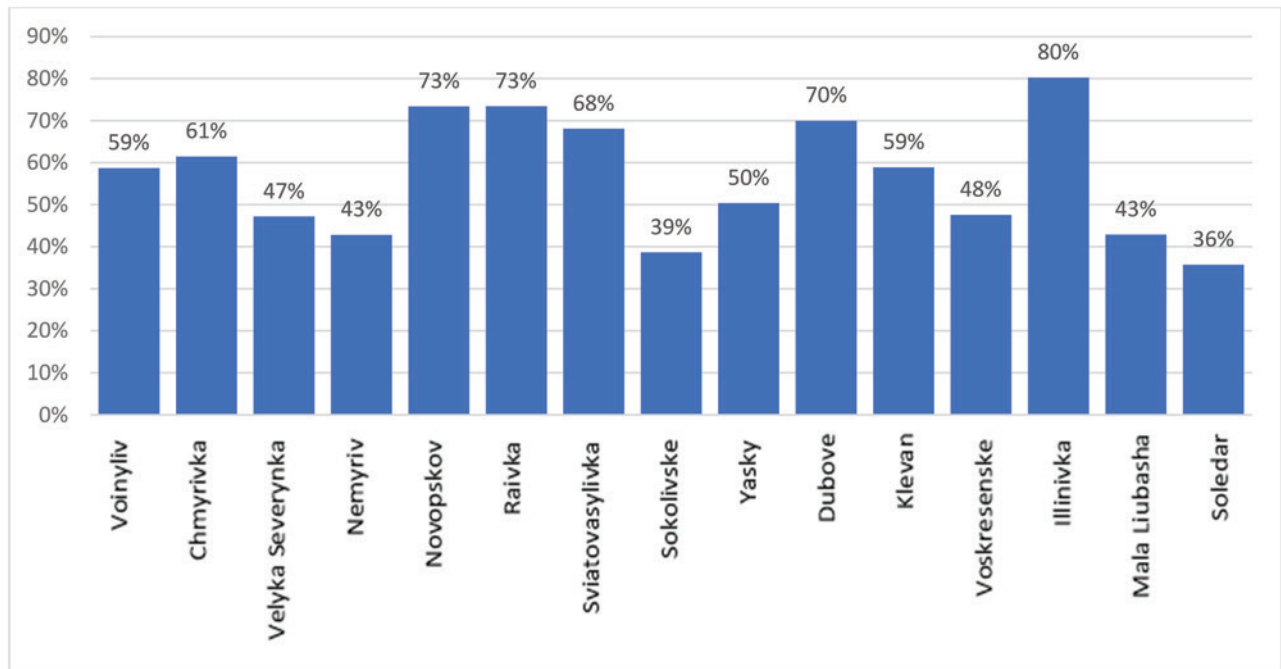


Figure 20. PIT share in own revenues of general fund (without transfers) in 2018, %

Table 3.

PIT revenues from AH public sector workforce in 2018

| AH               | Population as of 01.01.2018 | Per capita revenues (general fund), thousand UAH | PIT revenues, thousand UAH | PIT paid by public employees in total PIT revenues |
|------------------|-----------------------------|--|----------------------------|--|
| Klevan           | 11704                       | 5864,6   | 55071,1                    | 7%   |
| Novopskov        | 12192                       | 3477,0   | 29652,7                    | 12%  |
| Soledar          | 20891                       | 5782,0   | 88670,7                    | 13%  |
| Illinivka        | 9553                        | 5670,2   | 39756,7                    | 15%  |
| Nemyriv          | 15379                       | 5990,8   | 54074,4                    | 15%  |
| Sokolivske       | 6057                        | 7134,0   | 21774,4                    | 18%  |
| Velyka Severynka | 3547                        | 4613,1   | 6322,5                     | 29%  |
| Dubove           | 3636                        | 4563,3   | 10194,5                    | 31%  |
| Raivka           | 11073                       | 4142,6   | 21646,1                    | 32%  |
| Yasky            | 8482                        | 2078,5   | 6293,7                     | 32%  |
| Chmyrivka        | 6678                        | 2197,5   | 8644,9                     | 36%  |
| Sviatovasylivka  | 4290                        | 3521,5   | 6466,2                     | 37%  |
| Mala Liubasha    | 5785                        | 3193,7   | 7918,9                     | 37%  |
| Voskresenske     | 11168                       | 1564,8   | 8310,1                     | 51%  |
| Voynyliv         | 6501                        | 1106,8   | 4898,6                     | 67%  |

Besides this, local governments need to be aware that dependence on one or two major employers registered within a given jurisdiction could create risks for the stability of local budgets. A company's decision to re-locate its headquarters, which is a common practice, may have drastic consequences for the budget and the ability to finance essential costs, with a detrimental effect on hromada's fiscal capability.

► A common problem identified in all assessed hromadas is administration of PIT from branches and divisions of large employers such as Ukrtelecom, the nationwide telecommunications company, Ukrainian Postal Service, military bases, Ukrainian Railway, and some private sector companies that do not comply with the requirements of Article 64 of the Budget Code, namely that taxes "are paid to the account of a budget according to their location..." and item 3 of Article 168.4 of the Tax Code providing that "... the amount of PIT assessed by an autonomous division ... is also paid to a budget according to the location of this division". In reality, PIT is often paid according to the legal address of headquarters. According to the current tax legislation, this does not constitute a violation, since tax agents assess PIT, report and pay the correct amounts to the budget (the budget and tax codes do not specify to which exact budgets the PIT should be paid, more important is a fact that PIT was paid). There is no financial or administrative action envisaged against tax agents that do not comply with the stipulation that PIT should be paid according to the place of actual economic operation. Moreover, taxpayers challenge this stipulation on the basis of Article 64 of the Economic Code of Ukraine, which maintains that the functions, rights and obligations of organisational units are defined by regulations approved according to the procedure outlined in a corporate charter or other document of incorporation. This means that, in effect, the businesses themselves define the 'location' of their operations for PIT payment purposes, which could be inequitable for the AHs.

Using such legal provisions, some companies set up structured units that, according to their own regulations, are not granted the authority to pay taxes, maintain accounts and reporting, and hire the workforce. As a result, there are concerns about lack of information on assessed PIT amounts for employees of such arms' length units. Such PIT shares are paid to local budgets of jurisdictions where the company has its headquarters, not where an arms' length unit is located. Since Article 168.4 of the Tax Code refers only to arms' length units, it does not cover production facilities (manufacturing sites, workshops, bureaus, labs, task forces) and functional organisational units (services, bureaus, task forces) located elsewhere, and respective PIT shares also bypass local budgets in jurisdictions where their employees actually work.

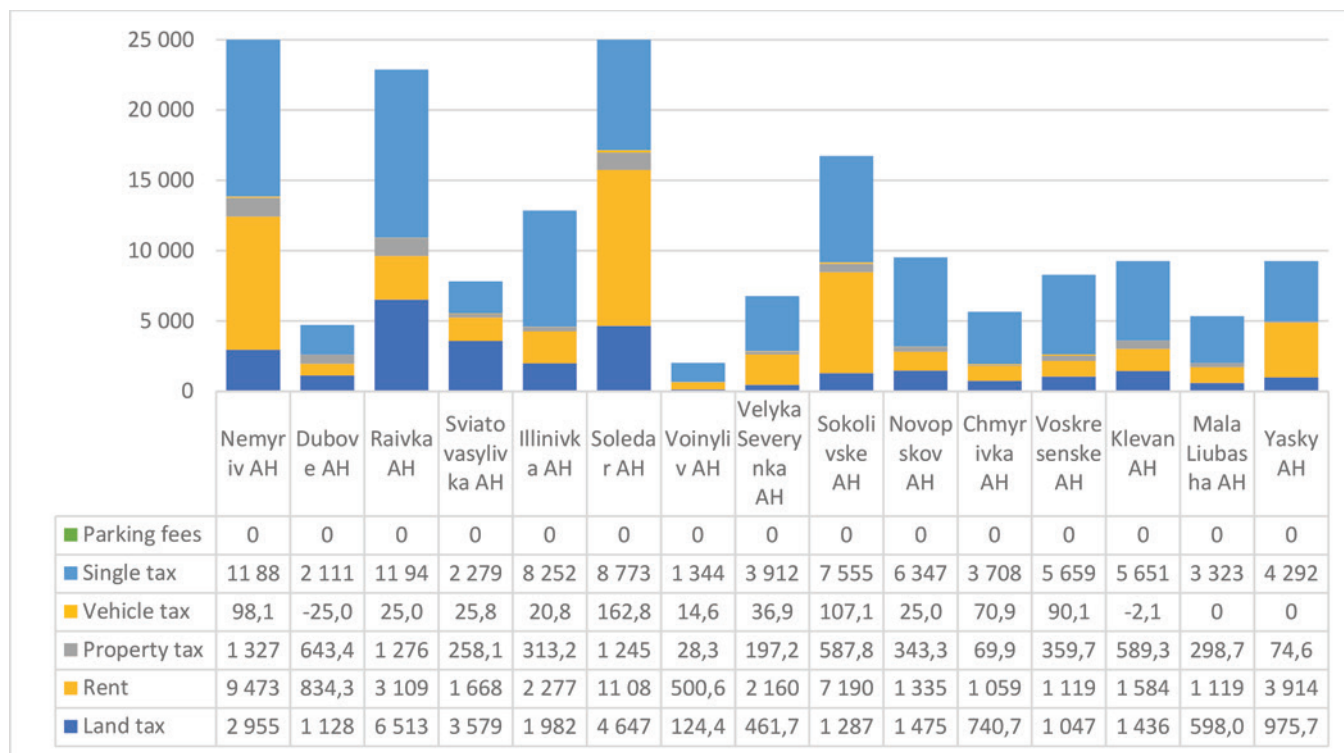
There are also cases when companies change their legal address which determines where their taxes go, but continue operations at the same location, and hromadas have no leverage to deal with such situations.

Shadow employment is another problem in hromadas. In many cases people do not want to receive official wages, or disclose only minimum wages in order not to lose their housing benefits. However, hromadas do not have sufficient powers to control employment, and they also cannot count on support from the tax authorities. This has both a negative impact on local revenues, and on the level of trust in the national legal framework.

► In 2018, the largest amounts of local taxes and charges were collected by the two largest AHs by population size, Soledar AH (UAH 25.9 million) and Nemyriv AH (UAH 25.7 million), as shown in Figure 21.

**GOOD PRACTICE.**

Yasky AH conducts outreach measures to discover late payments or unreported income. In 2019, it convened three committees on legalisation of wages, and committee compositions were approved by decisions of the executive committee. As a result, a business registered as an individual entrepreneur (Dutniev) dealing with construction materials registered three employees in the AH, and a similar small pharmacy business (Bodiul) plans to register two more employees in AH in 2019.



**Figure 21. Local taxes and charges in AH budgets in 2018, thousand UAH**

As seen from Figure 21, the existing system of local taxes and charges is not sufficiently diversified and effective, and some taxes are hard to apply to local budgets, especially in rural hromadas. For example, collection of parking fees in all assessed hromadas is almost zero. Revenues from tourism tax and vehicle tax are very small, particularly in comparison with other revenue types. Regarding property other than land, not all properties are registered; official databases include less than half of properties and digitalisation of records is very slow.

There are two local taxes that have the biggest fiscal impact for AH: the single tax paid by individual entrepreneurs and companies with the simplified taxation regime, and land tax from rent (mainly paid by companies for rent of communal land). One of the possibilities to strengthen the base for land tax is to include relevant data into the cadastre map and set a reasonable tax rate (considering economic and geographic factors, as well as valuation). It is also essential to involve starostas in detecting tax evasion. Finally, in order to improve administration of local taxes and charges, it is important to strengthen hromadas' efforts and performance in this area and review the mechanism of tax administration on the national level.

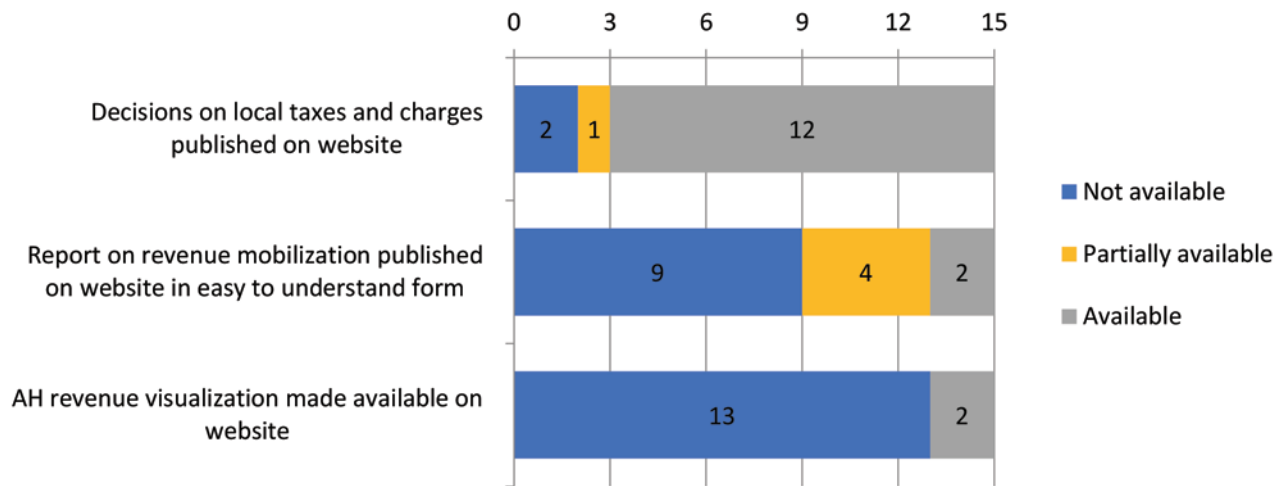
► Weak cooperation between hromadas' finance departments and tax authorities affect efforts to identify individuals and legal entities failing to pay local taxes and charges (as well as PIT) in a full and timely manner. Hromadas' do not have access to tax reports and are not authorised to collect debts, nor do they have any direct leverage with such companies as Ukrtelecom or Ukrainian Postal Service that have their arms' length units in hromadas but pay taxes in jurisdictions where they have their headquarters. According to hromadas' staff, they repeatedly contacted tax authorities requesting information about assessed and paid taxes, tax debt or taxes paid in excess that should go to local budgets, but were refused cooperation.

Thirteen hromadas track their revenues by taxpayer. Detailed databases of taxpayers that are active within hromadas bolster oversight and control over compliance with tax legislation and help reduce tax debt. Efforts to build communication with businesses and citizens, as well as awareness building in the community and among young people in particular, can bring

positive outcomes in terms of tax discipline and budget literacy.

► Regarding non-tax revenues, their share in all hromadas is quite small, calling for more attention to this source of revenue. In the majority of cases, the main sources include own revenue of budget-funded institutions and administrative fees.

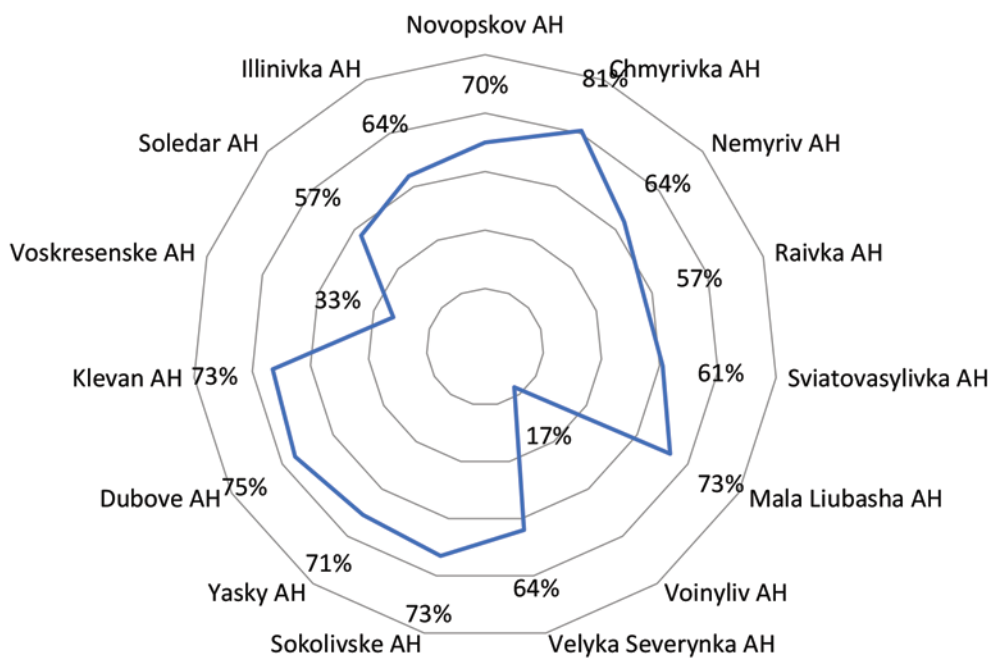
► Summarised findings on disclosure of revenue mobilisation in hromadas are presented in Figure 22.



**Figure 22. Disclosure of revenue mobilisation in hromadas**

As seen from the chart above, most hromadas comply with the requirement to publish decisions on local taxes and charges (with the exception of Voynyliv AH that does not have an official website). The best visualisation of the hromada’s revenues are provided only by Chmyrivka AH and Novoposkov AH.

► Total scores received by the assessed hromadas on procedures related to revenue mobilisation, dynamics and structure are shown in Figure 23.



**Figure 23. Total scores on revenue mobilisation**

As seen from Figure 23, most hromadas scored higher than 50%, which is encouraging. However, they need to continue to focus on improving transparency and accessibility of information about trends and sources of revenues, as well as the various factors affecting them.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Build closer cooperation with local offices of the State Tax Service for information sharing and joint measures, in particular tackling debt. This will help increase local budget revenues, enable continuous analysis of taxes and charges debt, and tracking of taxpayers who have not paid due amounts in full.
- Consider ways to strengthen the local tax base, for example, by attracting investors, and designing and approving an action plan on revenue mobilisation.
- Assess possibilities to increase PIT revenues by promoting official employment in the hromada and developing and implementing initiatives to create new jobs and prepare relevant forecasts.
- Consider introduction of charges and fees that are stipulated by law but not used in hromadas. If properly administered, they could provide a way to mobilise higher own revenues in hromadas.

### For central government:

- To enable hromadas to conduct robust revenue mobilisation and budget planning at all, provide them as a matter of priority with full data about projected amounts of inter-budgetary transfers from the national budget (in June-July of the year preceding the planning year). Currently, the indicators included in a budget forecasts are not detailed enough to carry out full estimation and anticipate all hromada revenues.
- In the same period inform hromadas of potential legislative changes that would affect their revenues in a medium-term perspective and efficiency of budget planning, also as a matter of priority.
- Stipulate clearly the frequency and form of information-sharing between tax authorities and local self-governments in hromadas on assessed taxes and charges to be paid to hromadas' budgets, and ultimately introduce automated information-sharing.
- Provide clear legislative provisions for payment of PIT from divisions and branches of companies to local budgets according to the place of actual operation, rather than at the legal address of headquarters. Amend current legislative provisions to address the anomalies in PIT payment by arms' length units of legal entities, which means that some hromadas are providing services to benefit local business operations but do not receive their PIT entitlement as they are effectively registered as located elsewhere, in particular by aligning provisions of the Budget Code, Tax Code, Economic Code and Civil Code and the Law on State Registration of Legal Entities, Individual Entrepreneurs and Citizens' Associations. It will be useful to update Article 168 of the Tax Code and Article 64 of the Budget Code with full list of types of units that a legal entity may have according to Article 64 of the Economic Code and that operate on territory beyond jurisdiction where the legal entity is registered, and to amend Article 127 of the Tax Code by establishing liability for breach of procedure requiring payment of PIT to local budgets.
- Revise the mechanism of fiscal equalisations as current mechanism doesnot take into consideration other than PIT sources of revenues to hromadas form state taxes and their shares (i.e accise tax, payments from rent from usage of natural resources).
- Through legislation, increase the powers of local governments to control and minimise unofficial employment.



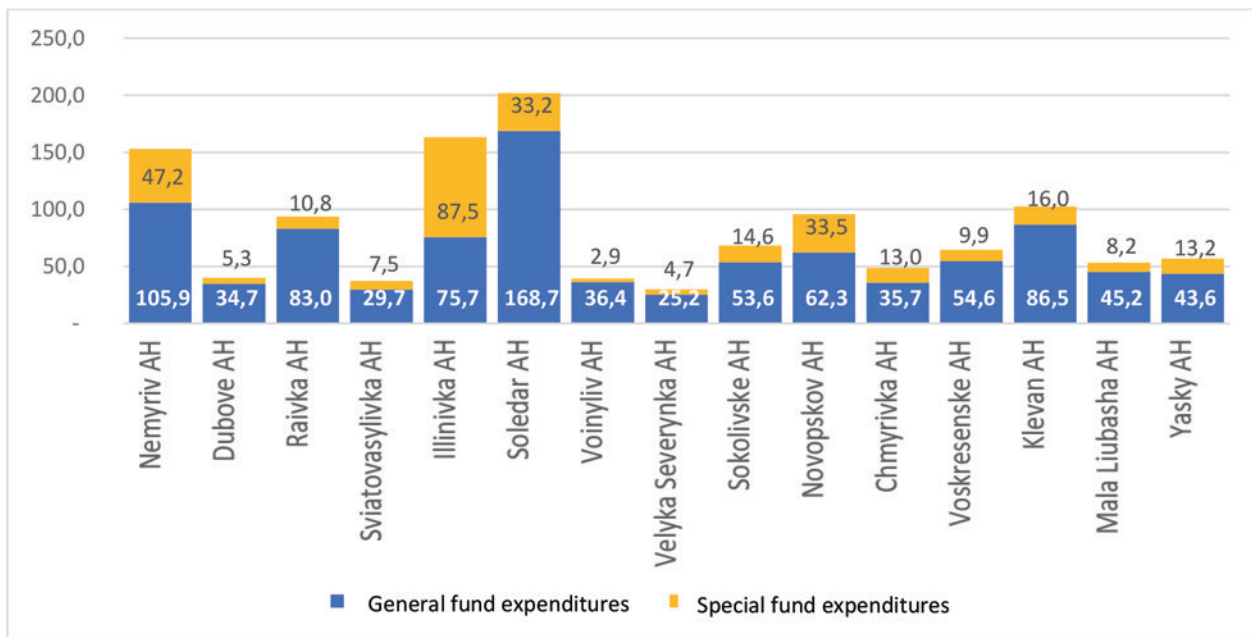
- Change the mechanism of assessing property tax by amending appropriate legislation and establish tax rates based on property market value rather than size.
- Revise powers of local governments with regard to supervising the administration local taxes and charges (and liability for non-compliance) to expand local governments' autonomy in these matters, and consider designating powers to collect local taxes and charges as own responsibilities of local governments.

## 7. EFFECTIVENESS OF BUDGET EXPENDITURE MANAGEMENT IN HROMADAS

This section looks into the dynamics and structure of expenditures by key spending units, and the functional and economic classification of expenditures. The focus was also on the level of detail of the spending part and formality of applying programme-based budgeting. A sample of programmes was used to evaluate the quality of performance indicators and whether gender aspects are included in budget programmes and management of budget resources. Finally, the analysis looked into the organisation of cooperation and information-sharing with the State Treasury.

### SUMMARY FINDINGS

► Among the assessed hromadas, the largest total expenditures in 2018 were found in Soledar AH, Illinivka AH and Nemyriv AH. These hromadas also had the largest expenditures in the special fund. Interestingly, special fund expenditures in Illinivka AH were higher than general fund expenditures, amounting to almost 54% of total spending. The data for special and general fund expenditures are shown in Figure 24.

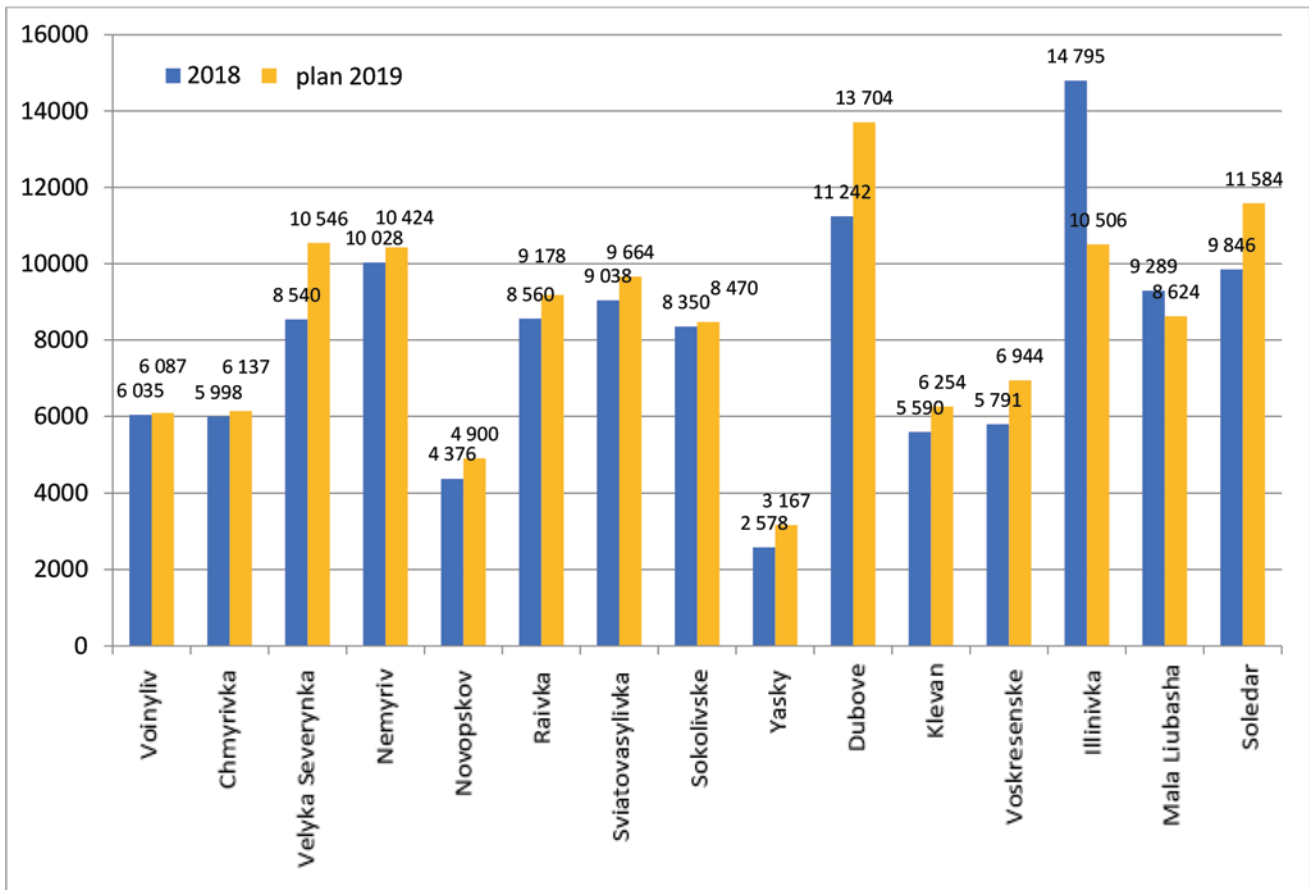


**Figure 24. Hromada expenditures by general and special funds in 2018, million UAH**

In the assessed hromadas, the average share of capital expenditure in total expenditure in 2018 was 20%. However, capital expenditure in Voynyliv AH did not exceed 6% of its expenditures, whereas capital expenditure in Illinivka AH (Donetsk oblast) represented half of its total expenditure. In Chmyrivka AH and Novopskov AH (Luhansk oblast) from ¼ to 1/3 of their expenditures were capital. Also, Nemyriv AH and Yasky AH allocate more than one quarter of their expenditures for capital and development projects.

► Comparison of actual budget expenditures shows considerable differences among the assessed hromadas both in terms of total expenditure and per capita amounts – from UAH 2,578 in Yasky AH to UAH 11,241.6 in Dubove AH and UAH 14,795 in Illinivka AH. In 2018, the average per capita expenditure across Ukraine was UAH 7,973.7 (Figure 25).





**Figure 25. Hromadas' per capita expenditures in 2018, UAH**

In 2019, different hromadas expect different growth of per capita expenditure, and some even anticipate a considerable decline. For example, decline is expected in Illinivka AH, due to changes in financing of capital expenditures from the special fund.

► The analysis of budget expenditures by functional classification reveals differences in expenditure structures that, to a certain extent, result from managerial decisions, prioritisation of spending, and available financial resources. However, it is also possible to identify common trends. For example, the largest shares of expenditure are those for education and local self-government operation (including executive bodies), and the smallest amounts are allocated for environmental protection and sport (Figure 26).

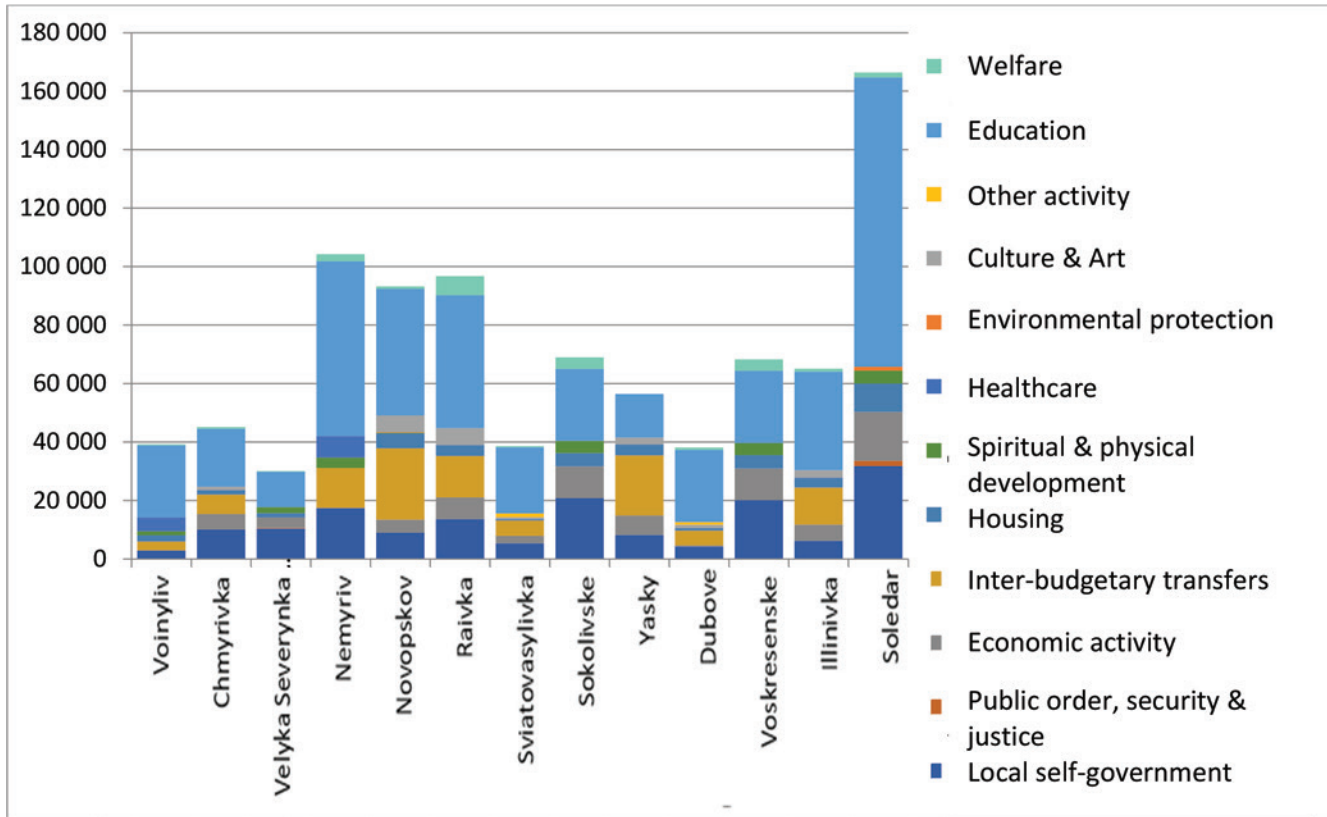
In 2018, just five hromadas envisaged expenditures on healthcare. This is caused by the fact that not all hromadas have their own healthcare facilities, or they rely on healthcare services reimbursement programmes.

► The analysis of budget expenditures according to economic classification reveals that, in all hromadas, the largest expenditure item is wages and social contributions, from 34% to 68% of total expenditures of general fund.

Most of the expenditures in hromadas' budgets are protected expenditure that can't be sequestered. They have a strong social focus, so that the primary objective is to meet the need for salaries and wages in budget-funded institutions, meals and medication, payment of electricity and gas bills, and similar. The majority of expenditure is spent on operating costs of local governments. Spending on energy is not high, seldom exceeding 7% of the total expenditure of general fund, and may even become lower, if hromadas continue their energy-efficiency efforts or increase own revenues. The average level of capital expenditure is 20% of total expenditure. After covering the

main operating costs, not much is left for development goals.

► Hromadas' spending on wages was assessed on the basis of the following documents: staffing plans, tariff scheme, payroll calculation for the draft budget, and actual labour costs.



**Figure 26. Hromadas' expenditures by functional classification in 2018, thousand UAH**

The assessment resulted in the following findings:

- ♦ All assessed hromadas have formal staffing plans and tariff schemes for their institutions, but only half of them are at the standard of quality and form required by legislation.
- ♦ In half of all cases, payroll calculation for the draft budget was only a formal exercise. Salaries and wages were not broken down by components, thus there was no possibility to see and analyse the structure of estimated projections.

On the basis of this assessment, hromadas were recommended to consider introducing and using modern IT tools to plan their labour costs. It would make the process of designing staffing plans, tariff schemes and payroll calculations easy, speedy and efficient.

► All hromadas were advised to strive to minimise amending the budget during the year. To this end, it was recommended to:

- ♦ conduct detailed analysis of what caused the need to amend the budget and identify measures to address these problems;
- ♦ consider the possibility to design and implement an action plan for rational use of budget resources, containing indicators that would allow for evaluation of effectiveness and efficiency of expenditures and budget programmes.

At present, preparation of the local budget forecast remains a formal exercise intended to ensure nominal compliance with budget legislation. In the majority of assessed hromadas, financial authorities prepare expenditure forecasts on the basis of current expenditure structures and

perform costing on the basis of indexes included in guidance letters circulated by the Ministry of Finance. Understandably, adjustments will be made depending on the real capacity of the budget for a particular year. It means that, in order to fully implement medium-term budgeting, local governments need to have exhaustive data on anticipated amounts of transfers from the national budget in medium-term perspective, as well as information about potential legislative changes that would affect their expenditures.

Even though the Ministry of Finance communicated to oblasts such projected amounts of transfers for 2021-2022, the actual amounts change after adoption of the budget and some transfers are allocated in the middle of a budget year. Thus, hromadas are objectively cannot take into consideration these amounts in the process of budget planning, which ultimately affects the quality of budgeting.

► All hromadas prepare documents stipulated by the methodology of programme-based budgeting. When planning expenditure, key spending units are informed about expenditure caps and make allocations among budget programmes at their own discretion. The draft decision on the budget is prepared on the basis of budget requests drawn up for all budget programmes, following standard forms and received instructions.

For all budget programmes, hromadas prepare passports and implementation reports. Budget requests and budget programmes may include additional indicators (other than those stipulated by the standard list). However, this is far from being a general practice, and most budget programmes contain only standard indicators. Just a few hromadas conduct evaluation of the effectiveness of their budget programmes.

► As for gender-responsive budgeting, the majority of assessed hromadas use this approach only partially. In Chmyrivka AH, for example, the welfare-related priorities and objectives, according to its socio-economic development plan for 2019, are to create the necessary conditions for delivering support to vulnerable groups, to improve the system of social services by making them more effective and targeted. Achievement of this objective will be possible only based on detailed analysis of problems, including gender analysis. The costs of such goals are fully included in budget programmes, according to the budget requests of key spending units.

When planning expenditures for pre-schools and informal education activities, Velyka Severynka AH takes into consideration the proportion of boys and girls, and what kind of extracurricular and leisure activities they are interested in. This hromada also analysed and partially considered the different needs of men and women that receive services within community social institutions. Special attention during budget planning is given to elderly people, citizens who are unable to work and require external assistance. An illustration of such focus is the "CARE" Programme (approved by the council session on 18 December 2018), which aims to improve the quality of life for economically-disadvantaged citizens.

**GOOD PRACTICE.**

When planning its budget expenditures for cultural centres, clubs, and leisure facilities, Chmyrivka AH takes into consideration the proportions of boys and girls and what leisure activities appeal to them.

The hromada also analysed and took into consideration the different needs of men and women that receive services and benefits (out of 10 programmes subject to gender analysis, five are related to welfare – support to talented youth, dental prosthesis for special subsidised groups, social support to families, children and youth, domestic violence prevention, gender equality, combatting human trafficking, children's recreation, etc.).

An electronic interactive version of the gender map was produced together with the youth council, an advisory body, as a unique tool in Luhansk oblast. It presents gender indicators in diagrams with differentiation by gender, age, and sectors. It is a good source of information to ensure equity between men and women and is designed for specialists employed in the public sector, NGOs, and research institutions who deal with various problems of men and women in various age and social groups

In Nemyriv AH, the passport of the budget programme under programme classification 3104 “Provision of community-based social services to citizens that need assisted living because of age, illness or disability” was developed using gender analysis findings. Gender aspects were also considered in the priorities of its programme of socio-economic development for 2017-2019.

Another example of outcomes of gender analysis application in the social sector is the Decision of Nemyriv Council No. 863 of 07.03.2019 adopting a regulation on “Affordable Social Taxi”, a transportation service for adults and children with physical (locomotive) disabilities. A documentation package was prepared and submitted to the Ministry of Social Policy for allocation of a specially equipped vehicle.

**GOOD PRACTICE.**  
**Velyka Severynka**

Priorities of the hromada’s programme of socio-economic development for 2019 are:

- improve public amenities to provide unimpeded access to road infrastructure for people with disabilities and other low-mobility groups;
- create a modern theatre studio in the hall of Velyka Severynka general public school to provide space for extracurricular activities for young people.

The tasks to be implemented by the hromada, as established in its strategic development plan for 2018-2022, include creation of advanced conditions for learning and development of children with special needs, specifically by equipping space in a kindergarten meeting high standards of modern education and suitable for children with special needs, including children with disabilities, to provide them with stimulating environment for learning and development.

Sokolivske AH has set the following tasks in its strategic development plan for 2018-2020:

- ♦ Improve the quality and expand the offer of social services, including a set of measures towards social protection of some groups that experience economic hardships, improving their housing situation and creating conditions for social protection of vulnerable groups;
- ♦ Create new, and modernise the existing, healthcare facilities, with major renovation of a rural health post in Vyshniakivka village with access for people with physical disability;
- ♦ Expand opportunities for meeting cultural needs and opportunities for healthy lifestyle, including conditions for harmonious development of children and youth, with good physical and mental health.

▶ As regards cooperation with the State Treasury, hromadas have stated that cooperation and information sharing is constructive, without significant problems in communication. Hromadas report on budget execution to the extent and in time determined by decree of the State Treasury No. 36 of 06.02.2018 on organisation of the State Treasury work on preparation of budget reporting on local budgets’ execution.

▶ Public access to information related to hromadas’ expenditure management information on official websites is shown in Figure 27.

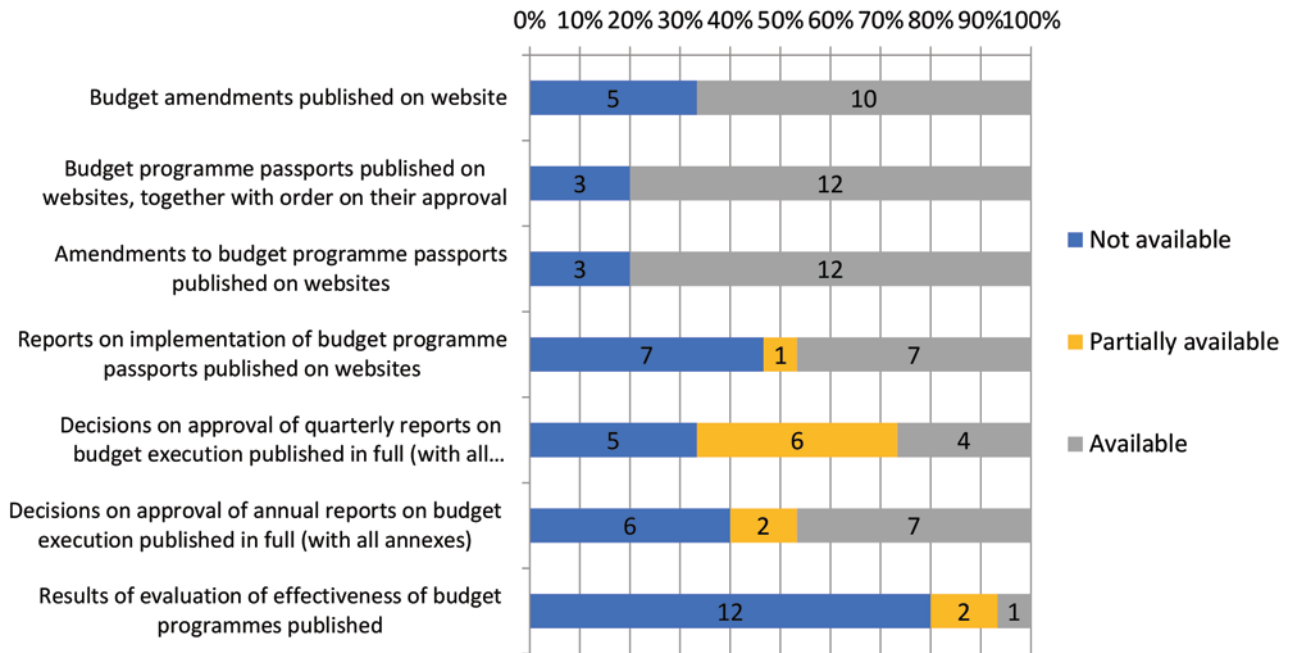
Figure 27 shows that information on hromadas’ expenditure management is not sufficiently available on official websites. Only one among the assessed hromadas publishes results of evaluation of budget programme effectiveness, while two more hromadas disclose this information only partially. Just two-thirds make decisions on budget amendments available to the public; 12 hromadas publish budget programme passports together with the order on their approval and all subsequent amendments. Reports on implementation of budget programme passports are published by just seven hromadas; decisions approving quarterly budget execution reports by five hromadas; and decisions approving annual budget execution reports with reports by six hromadas.

▶ Total scores received by the assessed hromadas from surveys and analysis of procedures related to expenditure management are shown in Figure 28

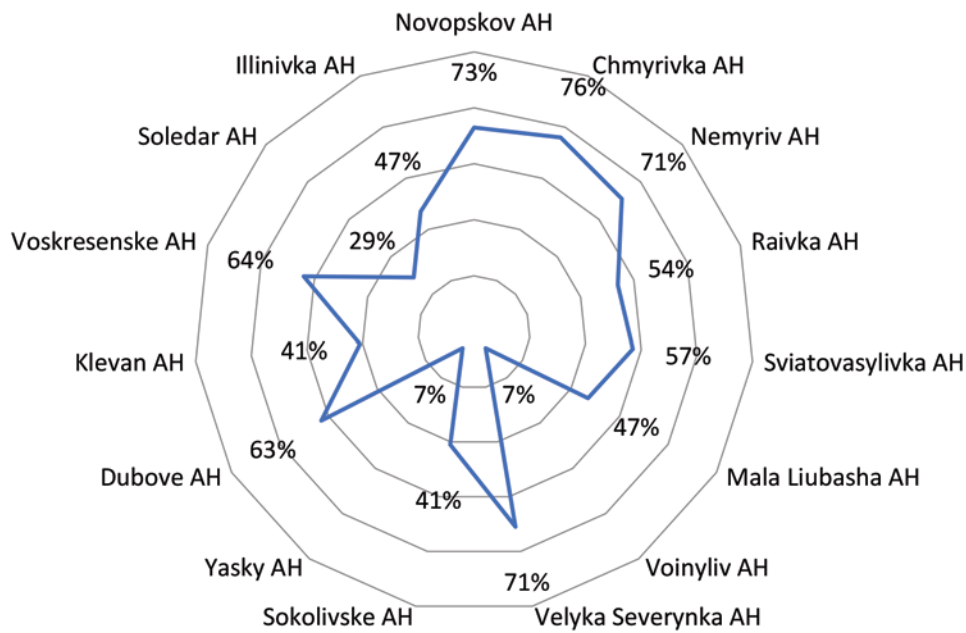
As can be seen from Figure 28, the total scores on expenditure management are lower than the



scores on revenue mobilisation. The highest score of 76% is shown only by one hromada, Chmyrivka AH, with Voynyliv AH and Yasky AH gaining the lowest scores of only 7%.



**Figure 27. Availability of expenditure management information to public**



**Figure 28. Total scores on expenditure management**

These findings may indicate weak awareness of the importance of effective use of resources gained through voluntary amalgamation. This inference is also supported by audit findings about misuse or inefficient use of budget funds by amalgamated hromadas published on the website of the State Audit Service<sup>1</sup>. Regrettably, the majority of hromadas still focus only on revenue

<sup>1</sup> <http://www.dkrs.gov.ua/kru/uk/publish/article/146977>

mobilisation issues, whereas managerial decisions to increase efficiency of spending are sporadic and formalistic.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Minimise the practice of amending budgets throughout the year.
- Make better use of opportunities offered by programme-based budgeting; above all, it is necessary to actively use performance indicators for budget programmes, in addition to standard indicators.
- Introduce evaluation of effectiveness of all budget programmes without exception, as this is required by budget legislation and should be mandatory, as well as helping the AH know whether their funds were used well and what they can improve.
- Base the evaluation of effectiveness of budget programmes on detailed analysis of implementation of all targets; evaluation results should be fully utilised by hromadas in their decision-making process and published.
- Consider the possibility to design and implement an action plan for rational use of budget resources, containing indicators that would enable the AH to evaluate effectiveness and efficiency of expenditures and budget programmes. Additionally the following measures could be taken in relation to: developing guidance for common expenditures, for example rulebooks for employees on use of municipal resources (including phones, cars, representation costs, etc), and public procurement and its efficiency (as the area that can yield either good savings or at least better value for money spent); energy efficiency; paying attention to wages of staff and its structure; and optimisation of school network and health care facilities
- Strengthen the application of gender-responsive budgeting and continue implementation of participatory budget (community-level initiatives) in hromadas, which will contribute to better transparency of local governments and help channel the financing to support certain gender groups and projects designed in close collaboration with and upon the initiative of the wider public.
- Reduce / do not increase the share of expenditures on administrative apparatus in relation to own revenues (without transfers), since increased administrative costs may decrease hromada's capacity to provide public services.
- Introduce municipal cooperation to provide more and/or higher quality of public services for citizens within the existing budget.

### For central government:

- To increase effectiveness of budget spending, continue improvement of the programme-based budgeting methodology, and in particular, ensure systemic revision of approaches used to evaluate effectiveness of budget programmes within local budgets and introduce a common methodology for such evaluation, and provide a mechanism for consideration of evaluation results in subsequent planning of budget programmes.
- Improve approaches to preparing local budget forecasts, ensure full implementation of medium-term budgeting for local budgets, and provide local governments with information about potential legislative changes that would affect their expenditures in medium-term perspective and ensure stability of presented indicators.



## 8. ASSET MANAGEMENT IN HROMADAS

This section presents an overview of hromadas' management of land and municipal property, including municipal enterprises. The areas of focus include completeness of records on land, validity of land leases, and whether a land inventory had been conducted. It also looks into whether municipal enterprises report to the community, publish their financial statements, whether there are financial plans approved for such enterprises, whether there is presentation of their implementation reports to the council, and whether and how quality of their services is controlled by the AHs. Part of this section is dedicated to analysing energy efficiency and energy independence of hromadas. This includes whether hromadas take measures to improve energy performance of buildings under hromadas' financing, and what are these measures, whether hromadas commissioned energy audits, and whether there is a comprehensive energy efficiency programme and action plan for sustainable energy for 25-30 years. Finally, the section includes findings about measures hromadas implement in matters of assets management.

### SUMMARY FINDINGS

► The assessment established that 13 hromadas have municipal enterprises. Their number depends on the scope and types of communal services provided and to a certain extent on population size. Thus, one of the largest among the assessed hromadas, Nemyriv AH, has four active municipal enterprises, Klevan AH and Soledar AH each have three municipal enterprises, Voskresenske AH and Yasky AH have two, and the remaining seven have one municipal enterprise each.

Five hromadas have established primary healthcare centres as non-profit municipal enterprises. However, the most common situation is setting up municipal enterprises for delivery of municipal services in hromadas, such as:

- Operation and maintenance of water supply and sewage;
- Waste collection and management;
- Services related to public amenities.

► It is very difficult to find information about economic and financial activity of municipal enterprises on hromadas' websites. The websites should provide information about the charter, services, prices, management reports, full financial plans and their implementation reports, as well as information on repairs that are ongoing and plans for repairs / construction. Some hromadas have a dedicated section on their websites, but they are far from being complete. If a municipal enterprise participates in procurement, its information can be found on external websites such as E-Data, ProZorro and others, but it is not convenient and not widely known.

Municipal enterprises are obliged to publish their financial reports online<sup>1</sup>, however, such information in the assessed hromadas was unavailable. The main source of information about financial performance of municipal enterprises are management reports submitted for approval by local councils.

To increase commercial viability of municipal enterprises, hromadas are advised to review their performance and pricing policy. The results of such reviews should provide insights into whether keeping such enterprises is socially and economically justifiable, or hromadas should look for alternative service providers such as, for example, private or state-run companies (if it would be cost efficient), and/or choose to increase fee-based services.

#### GOOD PRACTICE.

Novopskov AH introduced a mobile application "Open City" for citizens to report on problems, including those related to public amenities. Messages are received by an administrator that promptly communicates them to municipal enterprises. This saves both time and resources.

<sup>1</sup> Paragraph 8 of Article 78 of the Economic Code

► It appears that municipal enterprises demand significant bolstering from the budget, but hromadas so far have not looked into why these enterprises are loss-making or what financial support they require for objective reasons (for example, whether it is because of low prices or inefficient management). Hromadas believe that the main reasons for unprofitability are high cost of service delivery (the cost of services in hromadas is higher than in big cities due to logistics and distances) and low rate of collection of payments for services delivered.

Currently, municipal enterprises receive financing from the budget in amounts much higher than those they pay into the budget as profits. Unfortunately, because of incomplete information, it is impossible to analyse whether all hromadas have approved norms for retaining part of municipal enterprises' profits into their budgets. At the same time, all assessed hromadas stream additional budget funding to municipal enterprises that, depending on the AH, could be in different forms, such as investment into authorised capital, current assets, donations, etc.

► Hromadas actively manage their land plots and their land tax revenues are increasing each year. All hromadas have decided to introduce the land tax. Tax rates are revised annually, which influences local budget revenues. The tax rate ranges from 0.3% to the maximum of 12% (just two AHs). One AH established a lower rate for 2020 than 2019, to support local businesses. The assessed hromadas are also taking stock of land plots and performing land valuation, which should lead to them having more effective management of their land assets in the future. Almost all hromadas make lists of land plots for auctioning.

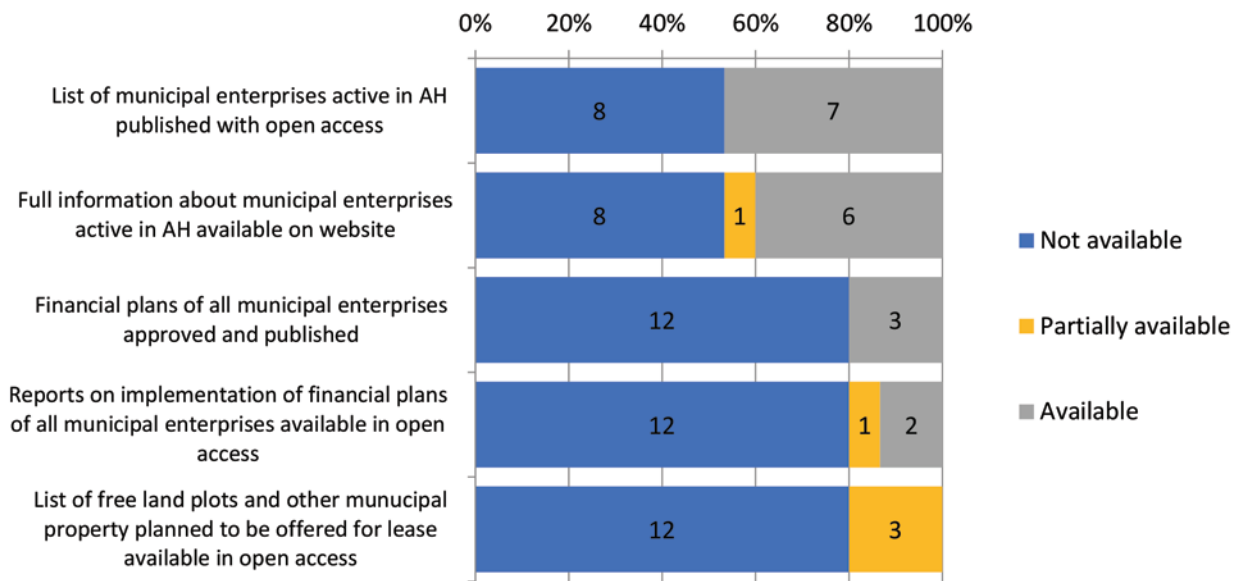
- Three AHs adopted programmes for the development of land relations with the main focus on:
- ♦ land plots valuation,
  - ♦ legal, organisational, economic, and technical measures for rational use of land resources of local councils,
  - ♦ prevention of undue re-purposing of agricultural land,
  - ♦ protection of land from human-induced effects,
  - ♦ restoration and increase of soil fertility,
  - ♦ securing of social land use regimes for natural and historical reserves.

Hromadas make continuous efforts to collect tax debts on land tax payments, both through special commissions and individual outreach. The biggest obstacle is limited access to information about tax payments, since tax authorities often ignore hromada's information requests. One of the solutions for AHs is the creation of their own databases of taxpayers, which Raivka AH did, for example, and finds is an efficient tool.

► All 15 hromadas implement measures to improve energy performance of public buildings for which they are responsible. Three hromadas conducted energy performance audits (Soledar, Yasky and Illinivka AHs). However, just four hromadas have comprehensive energy efficiency programmes. Eleven hromadas do not have a plan for sustainable energy development for 25-30 years, but energy efficiency measures are stipulated in other documents, such as socio-economic development strategies and target programmes. Capital renovation of public buildings and measures to improve public amenities are also performed with consideration of energy efficiency. The main energy-saving efforts include installation of double-glazing windows, replacement of doors, installation of solid-fuel boilers, insulation of building facades, replacement and insulation of roofs, and installation of technologically-advanced solid-fuel heating systems.

► Other measures for the effective management of property include setting procedures and processes to standardise the work of identifying, recording, preserving, and using landless property. Four hromadas have adopted such procedures.

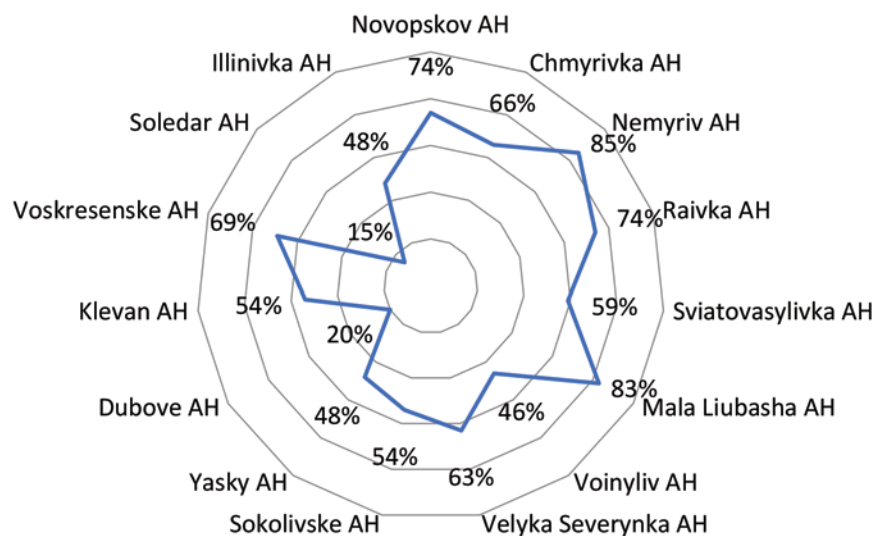
► The availability of information about asset management on hromadas' official websites is presented in Figure 29.



**Figure 29. Availability of information about asset management**

As seen from Figure 29, information about asset management is not sufficiently presented on hromadas' websites. Twelve hromadas either do not have or do not publish financial plans of their municipal enterprises; the same applies to implementation reports. Only Nemyriv AH publishes full information on all municipal enterprises. Also, 12 hromadas do not publish a list of free land plots.

► Total scores received by the assessed hromadas from surveys and analysis of procedures related to asset management are shown in Figure 30.



**Figure 30. Total scores on asset management**

On the whole, the scores illustrate hromadas' problems in asset management and its poor transparency. At best, hromadas follow only its legal obligations. Many of them give no attention to developing and regulating relations in the system of municipal property.

Since there is no clear definition of 'municipal property' in Ukrainian legislation, local authorities do not pay the required attention to municipal property as a material and financial basis of local

self-government and as one of the key sources of local budget revenues. This, together with other factors, creates an over-dependence on subsidies.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Carry out regular analyses of the performance of municipal enterprises, which will provide up-to-date information about their financial situation and proper planning of their support from the budget, and conduct a pricing analysis, determine whether prices are deflated, ensure that their municipal companies are 'financially healthy' (as it is better to provide subsidy to poor citizens directly or subsidize their fees).
- Continue the practice of publishing information about performance of municipal enterprises on hromadas' websites, as it is important to present regular information about financial plans for all municipal enterprises, and introduce regular public reporting of municipal enterprises' management and public performance results for all municipal enterprises (using performance indicators).
- Introduce monitoring of indicators for evaluation of level and quality of provided services, as a building block for an oversight system for municipal enterprises.
- Continue the practice of land valuation and in future avoid unjustified reduction of land tax rates.
- Develop and approve a comprehensive medium-term programme of energy efficiency and a plan for sustainable energy development for 25-30 years, and during the elaboration of these documents, include energy performance audit of all public buildings funded from hromada's budget.
- Step up efforts to identify and record property under abeyance and escheat property.

### For central government:

- Provide a definition of 'municipal property' in the legal framework, and recommend municipalities to keep municipal property databases with differentiation by types, classes and functional use of the property, which could be used for estimation its value and needs for investment.
- Consolidate and provide uniformity of a legal mechanism of subject–subject and object–subject relations in the area of municipal property.

## 9. ORGANISATION OF PUBLIC PROCUREMENT

This section reviews the availability and content of documents for conducting public procurement by key spending units in amalgamated hromadas, such as procurement plans, decisions on composition of tender committees, operating procedures for tender committees, regulation on below-threshold procurement and anti-corruption policies. Assessment was made of public procurement conducted by key spending units based on ProZorro data. In particular, frequency of procurement plans amendments was looked at, and whether there were cases of splitting procurement lots to avoid open tenders, etc.

### SUMMARY FINDINGS

▶ Key and lower-level spending units in hromadas conduct procurement in compliance with the Law on Public Procurement. All hromadas have operating procedures for tender committees. Sviatovasylivka AH and Chmyrivka AH also have authorised officials/person for conducting procurements. Novopskov AH is developing an anti-corruption strategy. However, hromadas do not have either regulations on conducting below-threshold procurements or regulations on anti-corruption policy.

▶ Hromadas' official websites have sections on public procurement; however, the information is incomplete and of poor quality.

▶ Annual procurement plans with annexes are published on the internet page of the body authorised to conduct procurement, which is in line with the Law on Public Procurement. For procurement of goods, works and services, the value of which is above UAH 50,000, a report on concluded contracts is published in the electronic procurement system, ProZorro. When the value of procurement is above UAH 200,000 for goods and services and UAH 1,500,000 for works, procurement should be conducted through an electronic system according to the Law on Public Procurement, and information should be published on the web-portal of the body authorised to conduct procurement. It should be noted that, on ProZorro, the annual plans and annexes are published without differentiation, and only the expected cost can give a clue as to whether it is an annual plan or annex. The data in the annual plans often reflects only current need in goods, works and services for corresponding procurement. This situation is typical for most hromadas. However, it is still in compliance with the public procurement legislation.

▶ The review of annual plans (together with annexes) and their amendments revealed that hromadas essentially do not have 'annual' plans as such, in the sense that each plan is actually designed for a particular procurement.

▶ The sampling of ProZorro portal for 2018 and 2019 revealed cases when procurement amounts were split, which was discovered in three assessed hromadas.

▶ The availability of information about organisation of procurement on hromadas' official websites is presented in Figure 31.

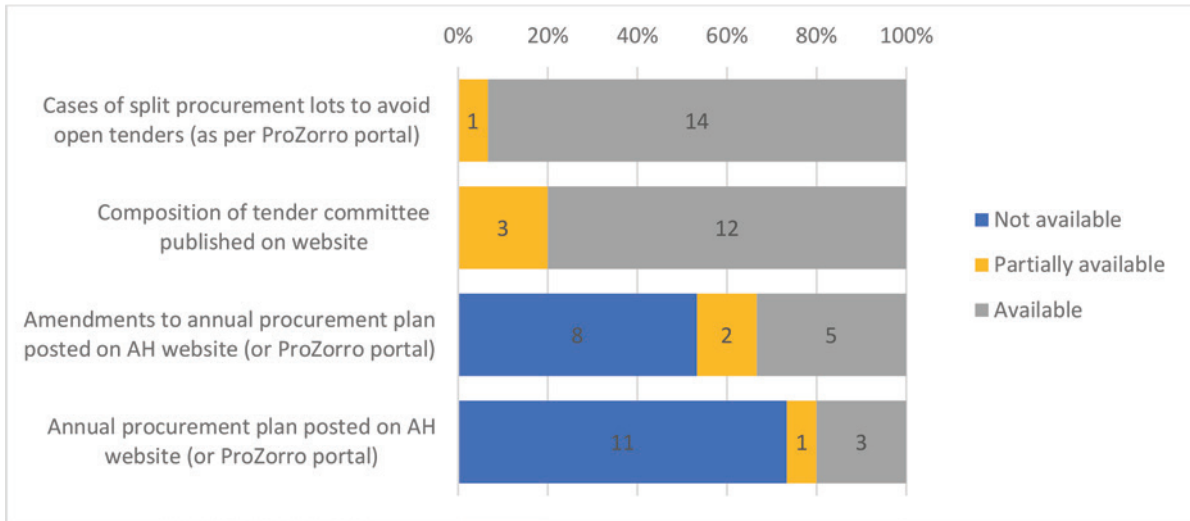
The assessment revealed that the main information on public procurement in hromadas can be found on the ProZorro portal. Generally, the work is conducted without violations and is in line with legislation.

▶ Total scores received by the assessed hromadas from surveys and analysis of procedures related to organisation of public procurement are shown in Figure 32.

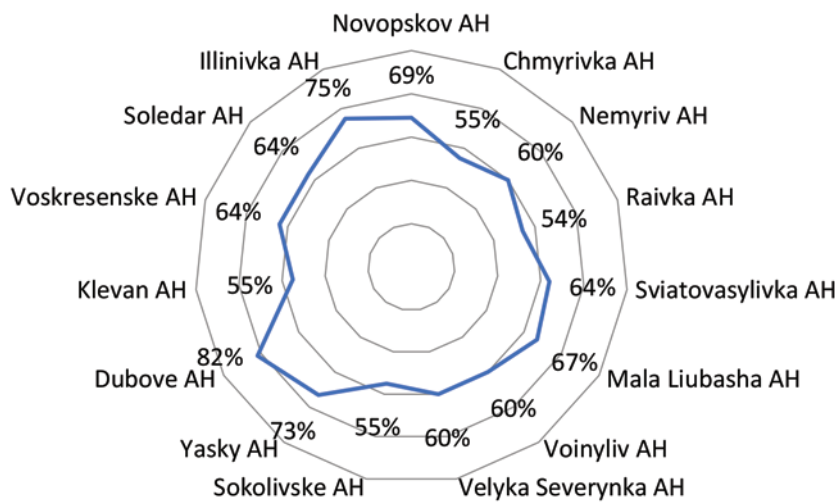
The diagram shows that the gap between the lowest score and the highest score from assessment of organisation of public procurement in hromadas is not very significant, in comparison with scores in other sections of the report. It is possible to conclude that the organisation of public procurement



in AHs is relatively smooth and there are few serious shortcomings in this area. Experts believe that what contributes to this rather stable situation with public procurement in all hromadas is clear and universal 'rules of the game' established in the framework legislation and guidelines provided by central government.



**Figure 31. Organisation of procurement and publication of information in hromadas**



**Figure 32. Total scores on organisation of public procurement**

## SUMMARY RECOMMENDATIONS

### For hromadas:

- For sound organisation of planning and forecasting of expenditures in key spending units, establish planned needs in goods, works and services for a whole year that would be compatible with the indicators of a spending plan, and design an annual procurement plan for goods or services that are planned to be procured during the year with consideration of budget allocations, not only for current month or half a year.



- After completion of the budget year, analyse planned and actual procurement , to contribute to clearer planning of budget spending for the planning period.

## 10. INTERNAL FINANCIAL CONTROL AND AUDIT IN AMALGAMATED HROMADAS

The section looks into how the internal control and audit systems are organised and operationalised in hromadas, and the extent to which they are comprehensive and coherent. Specifically, it looks at whether hromadas have internal auditors among their staff, whether there were audits conducted by the State Audit Service and if so, what were their findings and whether they were fully addressed.

### SUMMARY FINDINGS

▶ All assessed hromadas show only partial compliance with the requirements set forth in Article 26 of the Budget Code, regarding the introduction of internal control systems. This partial compliance was usually done through the implementation of some control procedures.

For reference: Article 26 of the Budget Code of Ukraine gives a clear definition of internal control and internal audit in the budget process, namely:

"3. Spending units, represented by their chief executive officers, shall organise internal control and internal audit functions, and make sure that these functions are performed in their institutions and enterprises, institutions and organisations falling under the management of such spending units.

Internal control is a set of measures applied by the chief executive officer to ensure observance of legality and effective spending of budget funds, achievement of results according to established goal, objectives, plans and requirements of activity of a spending unit and enterprises, institutions and organisations falling under its management.

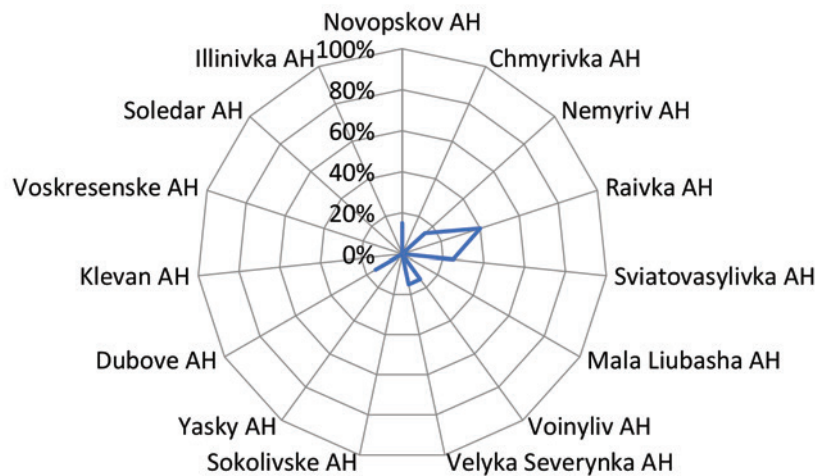
Internal audit is activity that focuses on improvement of the system of management, internal control, prevention of illegal, ineffective or inefficient spending of budget funds, occurrence of errors or other shortfalls in activity of a spending unit and enterprises, institutions and organisations falling under its management, and involves offering of independent conclusions and recommendations. For the purpose of internal audit, the spending unit represented by its chief executive officer shall establish an autonomous internal audit unit within its organisational structure, directly accountable and reporting to the chief executive officer."

▶ Concerning internal audit, spending units do not have organisational units or individual positions for internal audit in their structures. This has an objective explanation: their structure and staff are constrained both by administrative load per local self-government employee and by the amount of spending allocated for administrative costs. It is understood that it is not possible (and not even necessary) to create a separate organisational unit (for example in small AHs) or to introduce a new position without increasing the staff or financial burden. Moreover, in view of limited human resources and quite heavy functional workload, it is virtually impossible to assign an official to be responsible for carrying out internal audit. This situation is observed almost in all amalgamated hromadas.

▶ There is no information on hromadas' websites about establishment / functioning of internal audit units or results of any internal financial control measures. Here, it should be mentioned that this is an area where there are no stringent requirements to publish. It is important to have internal documents and procedures in AH, and have them ready for the auditors, but the citizens should see real results – more efficient and effective local government, with fewer wasted funds.

Thus, some elements of internal control are present, but they do not lead to a comprehensive and systemic approach. Hromadas should pay more attention to establishing effective internal control as part of sound financial management. Absence of internal control and audit systems creates risks of inefficient spending and weak asset management.

► Total scores received by the assessed hromadas from surveys and analysis of organisation of internal control are shown in Figure 33.



**Figure 33. Total scores on internal financial control and internal audit**

In comparison with other components of financial management in the assessed hromadas, this section reveals the biggest concerns and challenges. The highest score was just 40%, shown by Raivka AH, while eight hromadas scored zero.

These results indicate that active efforts are much needed in this area, and also suggest that hromadas do not have sufficient understanding of the role, importance, and essence of internal control. It may also indirectly imply hromadas' reluctance to exercise self-control and persistence of the stereotype that only external authority's control can be efficient.

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Design internal documents and officially adopt them in institutions to ensure functioning of internal control elements.
- Implement clear systems (procedures) for activity planning, implementation control and reporting on plans, tasks and functions, evaluation of achieved results and, if necessary, timely adjustment of institutional plans.
- Inform management of institutions about risks emergent during implementation of tasks and functions, carry out control measures, monitoring and information sharing.
- Introduce regular informing of hromadas' leadership and residents about the situation with organisation and performance of internal control.

### For central government:

- Prepare and approve amendments to current legislation to allow the possibility to create a separate internal audit unit.
- Develop guidance and methodological instructions for internal control in AHs

## 11. LEVEL OF AUTOMATION PROCESSES IN HROMADAS

This section focuses on hromadas use of IT systems for budget planning and execution. The analysis looked into satisfaction of hromadas' needs regarding use of such IT systems. It specifically inquired whether all key spending units are registered in the E-Data, the portal of public spending, and whether all data is entered in relevant sections.

### SUMMARY FINDINGS

► During preparation and execution of their budgets, all 15 hromadas use “Local Budget” software that provides automated preparation of budget requests, budget-related council decisions, generation of necessary annexes and budget programme passports. During budget execution, this software enables generation of provisional and permanent budget schedules, including electronic versions to be forwarded to the State Treasury departments, preparation of council decisions on budget amendments and necessary annexes, and also generation of reports to the State Treasury (Forms 2M, 4-1M, 4-2M, 4-3M, 7M).

According to hromadas' representatives, this software is user-friendly and convenient for management of the hromada's budget. It is used as a basis for updates on mobilisation of revenues, analysis of budget execution to prepare progress reports, operational informing about performed expenditures, analysis of financing, control of remaining allocations, and operational control over budget accounts. Specialists noted that all necessary documents during budget execution are prepared using the “Local Budget” software, and it enables automated preparation of budget schedule (current, constant), notes to financing schedules to allocate free surpluses, and, when receiving loans from the State Treasury, preparation of disbursement orders in paper-based and electronic forms.

► The “Local Budget” software enables transmission of information (such as contracts, side agreements, statements, delivery notes, etc.) directly to the E-Data portal (spending.gov.ua) through API, without use of transport files. It eases uploading of data to the E-Data accounts of key spending, making it fully automated.

► In the assessed hromadas, all key spending units are registered with the E-Data and enter all information in full.

Therefore, the software that is used by hromadas provides technical support to budget preparation and execution. The staff are generally satisfied with this software, but some also noted that it does not have the functionality to carry out automated assessment of the effectiveness of budget programmes and generate assessment reports. Today, this work has to be performed manually, and that is why it is not done in full scope.

► The findings about the level of automation in hromadas are presented in Figure 34.

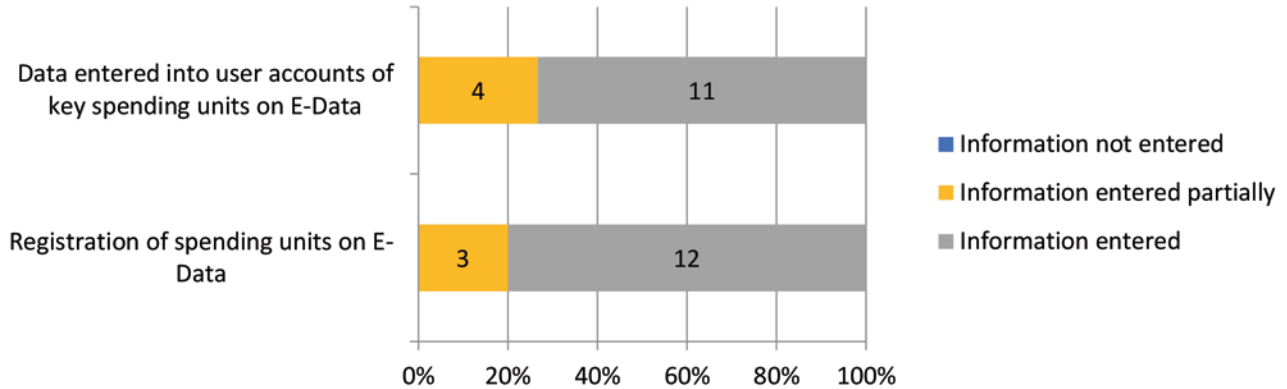
The assessment revealed no obvious problems in this area in the assessed hromadas. There are some shortcomings, but generally hromadas are satisfied with the available software.

► Total scores received by the assessed hromadas from surveys and analysis of digitalisation are shown in Figure 35.

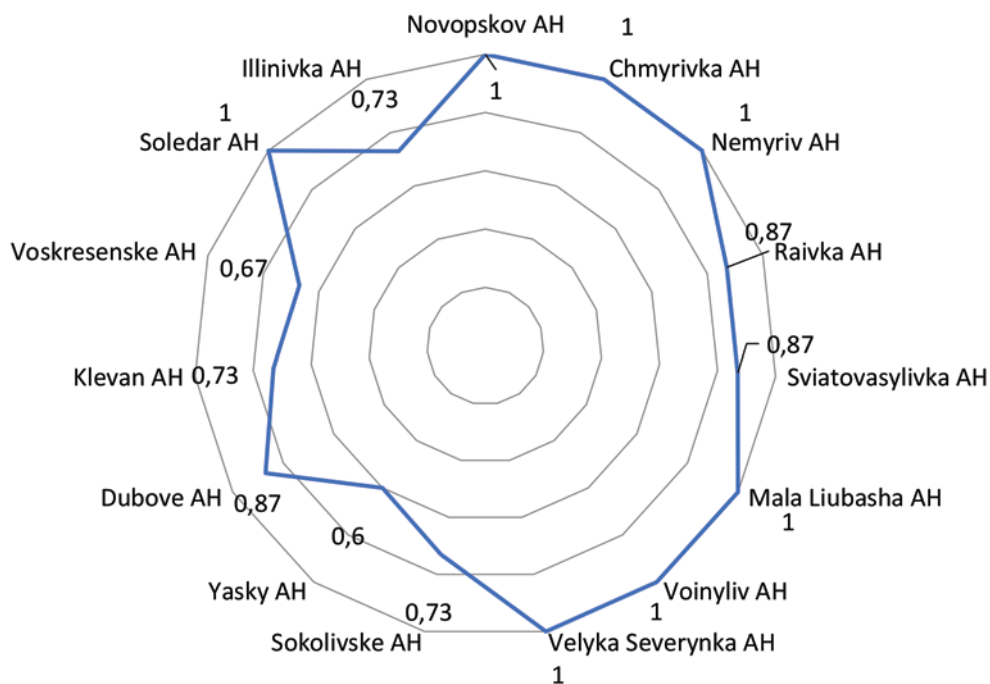
Figure 35 illustrates that, in this section, hromadas largely gained the highest scores, thus showing the best performance. It shows the acceptable level of digitalisation in hromadas and positive impact of the currently available software on quality of work delivered by local financial authorities.

However, experts believe that this software does not sufficiently meet the real needs in automation of all financial management processes that, each year, become more numerous and complicated.

For example, none of the hromadas has automated such modern management actions as evaluation of effectiveness of budget programmes, gender-responsive budgeting, forecasting of performance indicators, revenue simulation, etc. Therefore, as a way forward, it will be necessary to look for a more advanced software solution or upgrading of the existing one to be compatible with the present-day challenges regarding hromadas' financial management.



**Figure 34. Findings about the level of automation in hromadas**



**Figure 35. Total scores on digitalisation in hromadas**

## SUMMARY RECOMMENDATIONS

### For hromadas:

- Initiate upgrading of the “Local Budget” software to enable automated comparative analysis of effectiveness of budget programmes, reporting on findings, and generation of reports on effectiveness of budget programmes, which will help conduct automated analysis and evaluation of budget programmes and will serve as a basis for sound management decisions with regard to hromadas' finances.

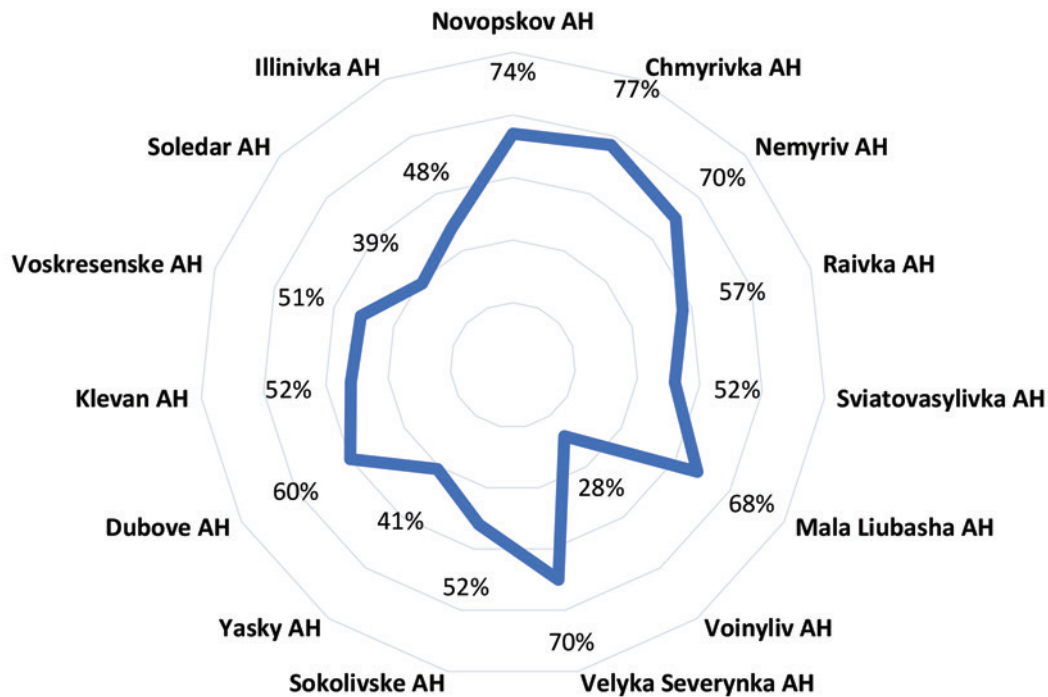
**For central government:**

- Roll-out development of a software (separate modules) enabling automated evaluation of effectiveness of budget programmes, forecasting and simulation of revenues and expenditures, consideration of gender aspects in budget planning and proposal of options for managerial decisions.



## 12. GENERAL FINDINGS OF THE FINANCIAL MANAGEMENT ASSESSMENT IN 15 HROMADAS

The resultant aggregate scores, based on the scores hromadas received on individual sections of the assessment, characterise the extent to which financial management processes are well-established and effective in hromadas (Figure 36).



**Figure 36. Aggregate scores on hromadas' financial management**

The summary findings of the financial management assessment in 15 hromadas expose considerable variation in percentage points gained by each assessed hromada, and hence variation in the quality of management actions in each hromada with relatively equal opportunities in terms of access to information, regulatory, organisational and institutional resources.

The effect from such divergence was explored in three aspects: the structure of individual scores; average values of scores; and parametric determinant of scores.

None of the hromadas gained the score of 100% (total maximum score in ten assessment sections). The highest scores (77% and 74%) were gained by Chmyrivka AH and Novopskov AH, respectively, in Luhansk oblast. The top five hromadas in terms of organisation of financial management processes according to IBSER methodology also included Nemyriv AH (Vinnytsia oblast), Mala Liubasha AH (Rivne oblast), and Velyka Severynka AH (Kirovohrad oblast), with 70%, 68% and 70% respectively. Although these are the highest scores among the assessed hromadas, they show considerable potential for further improvement of public financial management on the local level.

Seven hromadas attained 50%-60% towards meeting the requirements of sound management according to the IBSER methodology (see Figure 36). They need to invest more effort, including external advisory support and capacity building, in order to improve each of the financial management processes.

Regardless of scores, every assessed hromada has good and innovative practices in various aspects of management, but lack systemic approaches and well-established systems, which is why they require considerable support in terms of advice and expertise. If hromadas implement recommendations provided by experts in individual assessment reports, they will have a good potential for development. The basis for change is understanding shortcomings in management, and openness to innovation and constructive criticism.

On average, effectiveness of financial management in the assessed hromadas is 56%, which is higher than the mean score of assessed AHs according to the IBSER scoring method. Therefore, it can be assumed that, despite the unique characteristics of each hromada, the national system in general is characterised by the level of financial management shown by such hromadas as Klevan, Raivka, Sokolivske, and Sviatovasylivka. The problems identified in these hromadas are likely to be indicative of the existing trends and possible way forward in order to improve financial management in hromadas.

The value of parametric determinant (gap between maximum and minimum scores) in the assessed sample is 49%, which is more than half of the maximum observed score of 77%. It suggests a declining sporadic trend of the financial management system, not only in the assessed hromadas but presumably for all hromadas in Ukraine as a whole, since the sample is based on 10 different oblasts with good nationwide coverage (raising the sample frequency to 9.7%). This may indirectly indicate rather unstable, insufficiently resilient, financial management systems in amalgamated hromadas. Obviously, it will take time to reduce the degree of such determinism, which would manifest itself in smaller gap in scores. Time is needed for hromadas to contemplate their place and development in the new conditions related to authority and managerial powers, and to build necessary skills for autonomous exercise of given authority, without instructions from rayons and oblasts, but with full responsibility for budgetary decisions and the feel of real political, economic and financial freedom, which is the foundation for decentralisation of power in Ukraine.

At the same time, it is critical for central government to promote emergence and success of 'growth points' – examples of hromadas that are leaders and role models of successful practices that generate ideas and implement innovation, showing real positive changes in quality of services they provide to their residents and demonstrating the principle of financial autonomy and subsidiarity in action. Therefore, recommendations formulated on the basis of assessment and reflected in hromada-specific reports and generalised in this report need to be implemented in practice. It will also be necessary to conduct follow-up assessments of financial management quality in hromadas on the basis of standardised methodology and detailed surveys.

The results presented in this report in each assessment area reveal that hromadas lack:

- a) sufficient level of knowledge and skills among the staff necessary to improve their financial management; and
- b) clear taxonomies (digests with official 'rules of the game') for each thematic area assessed and presented in the report.

To address the deficiency in the knowledge and skills, which are common not only for hromadas within the first and second phases of the assessment, it will be necessary to conduct systematic and regular training in the most challenging aspects of financial management. This will provide the momentum to improve the effectiveness of hromadas' financial management in Ukraine.

In order to meet the need for taxonomies, it is advisable to produce and publish (in print and/or electronic forms) manuals for each of the 10 assessment areas, and disseminate them widely.





Kyiv, July 2020