

An Assessment of the Government Justifications for Budget Deviations in Road Construction Sector in Ukraine BY 2018

1) Description of the credibility issue. What did the government commit to do and what is the evidence that it did not do it? This should include a table showing the deviations over time.

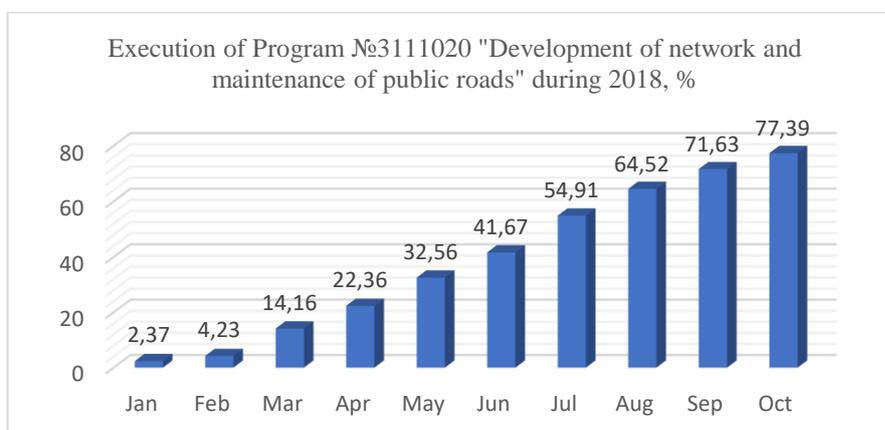
Due to the [decision of the Cabinet of Ministers](#), as a result of the execution of the Program directed on development of network and maintenance of public roads in 2018 – 492,426 km should be build & repaired and allocations should reach almost 11 Billion of UAH. As mentioned in the [Strategy of reforming and developing the road sector of Ukraine](#), over 90% of roads are in non-satisfactory condition. One of the key reasons mentioned in the strategy is low amount of money allocated for sector needs. Due to the latest available Accounting Chambers [performance audit report](#) “On the Performance of State Program on Road Development 2013-2018 № 3111020”, financing of road sector was conducted on a leftover principle (13-14% from estimated need). As mentioned on the p.24, during 2013-2015 only 60,03% from estimated expenditures were financed. Besides the fact of underfinancing, also a question of efficient use of scarce resources arises in the report. [State Treasury Service](#) provides different data on the level of execution of State Program.

BY	Estimates, UAH	Actual Spending, UAH	%
2013	9 907 869 339	7 457 744 883	75.27
2014	4 418 775 792	3 462 719 116	78.36
2015	6 134 423 631	4 553 889 189	74.24
2016	10 282 626 593	9 376 057 032	91.18
2017	13 762 311 912	13 292 717 036	96.59
2018	10 931 397 341	8 460 050 982 ¹	77.39

Table 1 Execution of the Program №3111020 Development of network and maintenance of public roads

During previous year level of execution has never reached 100%, as mentioned in Year-end reports of State Treasury Service, over last 4 years only 83,13% of funds in average were actually used from the allocated amounts. Reports of the State Treasury Service do not include narratives as they mainly perform only technical function of conducting transactions. In the research we'll try to find key reasons why underspending happens.

Latest available data on the execution of the Program shows us that during 10-month of 2018 level of spending has reached 77.39%. It is quite usual that most spending transactions happen closer to the end of the year. But how can we determine whether this is a good level of execution or not? We have to check the level of execution of the Program № 3111020 in Jan-Oct period in previous years: 2014 – 24.53%, 2015 – 46.92%, 2016 – 62.99% and in 2017 – 71,97%. As one can observe level of execution during Jan-Oct of 2018 has risen +6% in comparison to BY 2017 and is much better as in previous years. One of the key reasons is that in 2018 road fund has [been established](#). Due to the Law “[About the Sources of Road Sector Financing in Ukraine](#)”, a decision was made to establish Road Fund, starting since 01.01.2018 and target fuel tax and other [earmarked revenues](#) on road construction works. 60% of the resources of the Road Fund should be spend on the roads of national level, 35% on the roads of local level and 5% on activities related to road safety



¹ Level of the program execution during Jan-October 2018

From the diagram above, one can observe that in 2018 underfinancing of expenditures on road construction is highly possible. Additional factor of risk is [adoption of Martial Law](#) in Ukraine in late November as it can be considered as force-majeure. Due to the report of State Treasury Service during three quarters of 2018 (Jan-September), only 60% from the allocated resources for the road fund have been used (for details see [Annex 23](#)) Execution of the Program № 3111020 was slightly better and reached 71,63%. Resources of the Road Fund can be divided into three major groups: first one is subvention from State budget to local budgets – execution of this budget line during Jan-Sept of 2018 reaches 71,8% level of execution, second group – programs operated by State Agency of Automobile Roads of Ukraine – average execution rate - 62,4%, and Expenditures on Safety – 0%. During October expenditures on road safety activities have been reallocated for other purposes but no information in Media with explanations appeared. During the latest report of the Head of Road Agency to the Cabinet of Ministers on the 21.11.18, [Slavomir Novak](#) mentioned that 95% or works were performed on the roads of national importance.



Visualization of the level of utilization of the subvention from Road Fund to local budgets (30.10.2018)²

By the information of Ministry of Infrastructure regional administrations have delays with spending resources of the Road Fund as in 2018 roads of regional importance have been transferred to regional administrations and some of them were not able to hire staff for efficient execution of new duties.

We have compared the level of execution of state Program “on development of the network and maintenance of public roads № 3111020” with overall execution of all capital construction costs of state budget and total expenditures spend on road construction during last 5 years. As can be seen from the Table 2 Level of execution of expenditures in road sector are much higher than execution of capital expenditures of State Budget, but we couldn’t find any correlation. Low levels of execution in capital construction during 2014-2015 can be explained by the military aggression of Russian Federation towards Ukraine and occupation of Crimea and parts of Donetsk and Lugansk regions of Ukraine. Execution of road sector costs and state Program as well as execution of capital budget has a clear tendency towards improvement.

BY	Execution of total capital budget ³ , %	Execution of road sector costs ⁴ , %	Execution of state program №3111020, %
2013	60,32	78,93	75,27
2014	49,93	91,42	78,36
2015	68,91	90,70	74,24
2016	73,92	93,54	91,18
2017	77,23	96,80	96,59

² Data is provided by the Ministry of Infrastructure

³ Annex of the Year-end report on the execution of the State Budget BY 2013-2017 (economic classification)

⁴ Annex of the Year-end report on the execution of the State Budget BY 2013-2017 (functional classification)

2) Evidence of impact of the credibility issue. Describe the importance of the issue with reference to available nonfinancial indicators.

Unfortunately, no one is measuring economical losses obtained due to non-constructed roads. General impact of underspending and underfinancing of road sector is mentioned on the p.10 of the [Strategy of reforming and developing the road sector of Ukraine](#) - there are significant economic and social consequences of road sector current state, among them:

- reduction of the competitiveness of the domestic economy, in particular due to the growth of transport costs in the structure of the economy;
- a significant increase in the cost of maintenance due to untimely repair and therefore - roadway wrecking and falling into disrepair;
- reduction of traffic safety and further increasing road deaths;
- restraining of socio-economic development of the regions and reducing the level of labor mobility;
- lowering of medical firefighters and another urgent services availability;
- growth of social tensions

Some data can be found in the [Year-end Report of the State Agency of Automobile Roads of Ukraine](#) includes document – Report on the execution of passports of state programs. Form of this report is [adopted by the Ministry of Finance](#) and includes a set of Input, Product, Result and Quality indicators that are designed to describe results & efficiency of the programs in quantifiable manner. For example, in 2017 due to underspending of the program № 3111020 - 2 km of roads were not overhauled, passportization of the roads and electronic cadaster haven't been made, 90 km of roads repairs were not finished in 2017, three applied research in the field of road transportation were not conducted. Interesting peculiarity of this document is that underfinancing is not mentioned in it, despite the fact that there are Input indicators which include all sorts of data except input indicators as budget allocations, manpower, quantity of land purchased for road construction etc. Comparison with planned figures is available but still no explanation on deviations and their reasons. I noticed an interesting thing - that Form of the Report adopted by the Ministry of Finance has a block that obligates State Agency to identify and explain reasons of deviations (see paragraph 7 “Requirements for composition of the report on the implementation of the budget program passport”) and has a title “Report on the execution of state program” and document that is published by the State Agency is titled slightly different - “Information about the execution of state program”, such tiny correction cuts out a whole block of data devoted to explanation of deviations that happened during the program execution.

One of indirect impact indicators of underfinancing in road sector is [level of road accidents](#) which due to report of National Police has risen from 138 536 accidents in 2015 to 162 526 accidents in 2017.

[Explanatory note to the amendments of the Budget Code](#) in 2018 mentions that according to the World Bank research, economical losses of Ukraine from the unsatisfactory state of highways reaches 3-4% of GDP.

3) Summary of process followed to obtain information. Describe challenges faced in obtaining data on credibility challenge and in obtaining a justification for the deviations observed

Key data was obtained via monitoring of official web-sites of related state bodies. During the research, web-sites of the Parliament, Cabinet of Ministers, Ministry of Finance, State Treasury Service, Accounting Chamber and State Agency of Automobile Roads of Ukraine were monitored.

Key budget documents in Ukraine either missing narrative or have very little of it. For example, Year-end report on the execution of State Budget does not include narrative and information on the reasons of deviations from the planned allocations. State Agency published a modified report with slightly different title that differs from the form that is adopted by the Ministry and lacks data on the reasons of not reaching planned indicators. Not all planned interviewees agreed for the interview.

4) Review of official documentation related to the issue. Describe all official reports in which the credibility issue is mentioned and what is said about it.

[Strategy of reforming and developing the road sector of Ukraine](#) includes a general list of socio-economic impact of bad roads.

[Concept of the State Target Economic Program for the Development of Public Roads of National Importance for 2018-2022](#) has a clear list of reasons why underutilizing happens but no quantitative data is available. For example, non-rhythmic financing, chaotic planning of works on road construction sites, high level of subjectivity, lack of objective information on the state of roads, cases when State Treasury Service didn't conduct payments, public procurement issues.

[In-Year Report of the Execution of State Budget provided by the State Treasury Service](#), include data on actual spending.

Year-end reports on the execution of State Budget (2014-2017) have very little relevant data. A portion of non-financial data is mentioned in [explanatory note](#) to the Year-end Report on the execution of the State budget of 2017. It mentions quantity of resources utilized by the program, kilometers of automobile roads that have been constructed and maintained, quantity of road signs placed during budget year, but no comparison with planned figures, also no mentioning about deviations and their reasons.

[Year-end reports of the State Road Agency](#) especially report on the execution of passports of state programs have a lot of quantitative data on key performance indicators and their execution. Narrative is also provided in the explanatory note, but it lacks explanation why deviations happen.

[Performance audit reports provided by the Accounting Chamber of Ukraine](#), include opinion of state auditors on the compliance, efficiency and effectiveness of expenditures conducted during the execution of road construction program.

Review of official reasons offered during interviews. List any reasons provided in interviews.

Vitaliy Styozhka, expert in road sector, mentioned that one of the reasons of underutilization is a low quality of work of bureaus that produce project documentation, drawings and calculations for the road construction documentation. Also, a lot of time is lost during the project adoption and confirmation due to high level of bureaucratization. Low level of control over the quality of construction, conflicts of interest as the agency combines functions of client and also performs control functions that leads to high corruption risks. In his latest interview Head of the Road Agency – [Slavomir Novak mentions](#) about strengthening of control function of the Road Agency and additional procedures performed before accepting works from contractors. He also says that Road Agency will force construction organizations to fix inaccuracies if such were to appear during warranty period. Vitaliy Styozhka adds that State Agency should manage to publish data on the quality of roads that has been gathered by the Agency as well as publish information on warranty periods and contractors for the segments of road construction that were funded by the Agency.

Nataliya Forsyuk, Head of [Cost Ukraine Initiative](#) says that low level of planning is a consequence of lack of technical data - passports of roads are absent, level of data digitalization in the road sector is very low, digital system for road management is underfinanced and does not influence the objects that are picked for the draft of the decree to be adopted by the Cabinet of Ministers. Also, there is a factor on shortening the building season due to the fact that list of objects has to be adopted by the Cabinet of Ministers and it usually does it closer to the end of January. Due to this a whole month is lost. State auditors [mention](#) that in previous years state program 3111020 didn't include list of objects that were to be build, repaired, constructed or maintained. It is known that in 2020 revenues of the Road Fund will double. This leads to a [risk](#) that current quantity of building organizations wouldn't have enough capacity efficiently utilize these resources.

Olga Zelenyak, public procurement expert - states that there are issues in public procurement. Low level of public procurement documentation leads to lowering of the competition and execution. In some cases, such attitude of the state bodies (that perform customer functions) is intentional and is used as a leverage to pick "the right" contractor. There are plenty of cases when tender trolls appear in public procurements and send appeals to different control agencies only to jam the procurement process. Appeal to control agency often leads to postponing up to 3 months, such operation will cost only 500\$ while price of the tender can be millions of UAH. This issue can be solved via adoption of amendments to the regulatory framework connecting the price for the appeal to the price of the tender, via formula that can be discussed. Such approach will significantly lower motivation for tender trolls.

Victor Sasin, Director of the department of strategic development of the road market and road transport at the Ministry of Infrastructure explains that data of State Treasury Service on the execution of road fund shows the situation in the sector with some time lag as a lot of works have been done but not paid yet, as control activities are still performed by the Road Agency. Talking about utilization at the regional level the most efficient way of motivating regional administrations to show performance is to redistribute resources from the regions that are not capable to utilize them to the regions that are. In his opinion level of utilization of resources is highly dependent on the head of the administration, head of the road department and staff that prepares tender documentation. Strengthening of management and staff trainings should positively affect the process of funds utilization.

Artem Hrynenko, Ex-head of the SoE "Roads of Ukraine" [mentions](#) that main reason of underutilization on the local level is the absence of management mechanisms on the local level. For example, funds are transferred to the accounts of local administrations, but they can be used only on construction purposes, and often such situations occur that administrations do have the money but can't spend them on purchasing of new equipment, install automatic weighing systems in motion (WIM), use funds on laboratory checking activities over the quality of work, etc. Moreover, there is lack of skilled specialists, and no machinery at

all to perform high volumes of road construction works. Hrynenko [explains](#) that there is a request from local administrations to develop and implement a single, unified model of management and maintenance of highways of local importance. In his [opinion](#) there are 4 major strategic problems that affect underutilization – public procurement issues, low level of competition between contracting agencies, existing system of quality control and acceptance of works and bureaucratization of pricing in building sector.

Recommendations:

- to strengthen responsibility of project bureaus for providing low quality of project documentation.
- to strengthen control over the completeness of payment of taxes by all participants in the market of petroleum products, which will increase the percentage of earmarked revenues to the Road Fund of Ukraine.
- to develop standard procurement documentation for the roads of different categories and implement such standards
- tackle “tender trolls” via adoption of amendments to the regulatory framework connecting the price for the appeal to the price of the tender, via formula
- adopt mechanisms of independent external control over the quality of road construction (engineer-consultant)
- establish weight control of trucks to prevent destruction of roads. (Hrynenko [evaluates](#) annual losses from overweighted trucks in more than 2 billion of UAH)
- establish clear and transparent system of elimination of shortcomings by contractors.
- to widen the building season, it may be useful to make amendments to the regulatory framework and to produce draft of the Agency’s budget with clear prioritization of objects for repair and capital construction. In such case list of objects would be available at the moment of adoption of the state budget.
- establish transparent criteria for the prioritization of road works and overhaul, bust the usage of digital system for road management
- shift from the conduction of current-medium repairs (which excludes the procedures of control on the stage of acceptance by the bodies of architectural and building control) to the conduction of overhaul should lower corruption risks and strengthen responsibility of contractors.

Conclusion: How can government improve the way in which it describes and justifies budget deviations?

- Strengthen explanatory notes to the Year-end report of State Road Agency with explanations on the reasons of deviations and amendments done to the programs during the year and their influence on KPI. Provide additional analytics on the priorities of the Road Agency.
- Publicly report back to the Senior Audit Institution on the actions taken after receiving recommendations of Accounting Chamber developed on the results of performance audit.
- State Road Agency should develop the methodology of state budget programs in road sector performance evaluation, that was recommended by the [auditors of Accounting Chamber](#). And not only develop it but perform it as well and provide such analytics in the year-end report.
- Ministry of Infrastructure should establish clear system of data management and accountability in road sector. As currently there are disturbing signals on [cancellation of report forms](#) that have been used for gathering data on the execution of road works.
- Ministry of Finance should strengthen control over accountability of spending units to avoid replacement of reports on the execution of the budget programs with information notes that exclude crucial information.
- Publication of data on the quality of roads that has been gathered by the Agency as well as publication of information on warranty periods and contractors for the segments of road construction that were funded by the State can open up a mechanism of public participation over the control over the quality of road works conducted.

Table 1

<i>Assessment of Reasons for Budget Deviations</i>	<i>Is the government's justification according to this criterion adequate, somewhat adequate, or inadequate?</i>	<i>Explain why you rated the justification as adequate, somewhat adequate, or inadequate below:</i>
<p>1. Identify a causal link between a set of facts (A) and deviations from the budget (B). (Minimum Condition) A government should explain why actual performance deviated from the original projections in the budget. For example, actual revenue or expenditure may be different than the budget for reasons related to the economy, to changes in policy, or to technical factors such as errors in predicted participation rates in a program or tax credit. These facts could be used to provide a causal explanation for budget deviations.</p>	Somewhat adequate	The link between underfinancing and deviations should be described in the Report on the execution of the State program. Information that is published by the Government includes data on budget allocations, information on amendments and level of funds utilized during the budget year (YER of the State Budget). State Agency publishes its' own YER where annexes are present with the level of execution of key performance indicators, including non-financial ones. However explanatory note to the Report of BY 2017 has a poor quality and does not include explanations and reasons of not-fulfilling of planned indicators. Reports of previous years have at least a sentence with the definition of a key factor that lead to underfinancing.
<p>2. Explain the mechanism by which a set of facts (A) has caused deviations (B) and, where possible, what (C) caused (A) in the first place. If A (facts) caused B (deviation from budget), how did A cause B? A causal statement is more powerful if it explains the mechanism through which A caused B. For example, assume government identifies an economic shock as having caused revenue to decline below forecast levels. Explaining the mechanism by which this occurred would require providing evidence showing how the economic shock resulted in lower economic growth, which led to lower employment and lower incomes, which in turn reduced collections for major tax heads like income tax and VAT. In cases where A was under the government's control, such as when it was caused by a policy change, at least some explanation for this (C) that caused (A) should be provided. For example, if revenue decline (B) was caused by failure to implement an automated revenue system(A), why was the system not implemented? Only one additional reason for (C) needs to be identified.</p>	Somewhat adequate	As mentioned above YERs on the execution of the State Budget and State Road Agency have no explanations on deviations and reasons of funds underutilization. There is minority report that State Agency is not interested in publishing of information that could compromise or have negative public affect, even when it is required by the bodies that perform state control (for details see p.3) that's why information on actual reasons of underspending was never published. However, some mechanisms are explained in the report of the Accounting Chamber. For example, on the p. 7-15 of the Performance audit report (Program №3111020 during 2013-2016) one can find explanations on juridical gaps that cause low level of income of earmarked revenues that otherwise would be spend on road construction and maintenance.

<p>3. Show whether the facts (A) fully explain the budget deviations (B), including their components. If a set of facts (A) explains a deviation from the budget (B), is the set of facts sufficient to explain any variation in the deviation when it is disaggregated into its component parts (B₀, B₁ and B₂)? For instance, assume overall expenditure has declined, but that some types of spending increased while others decreased. The facts presented should be sufficient to explain both facts: overall spending on health might have decreased because uptake of a large insurance scheme was below target, but spending on health infrastructure was faster than expected due to the sudden resolution of outstanding legal cases that had barred construction on contested land.</p>	<p>Inadequate</p>	<p>As it is mentioned above, no narrative on deviations and reasons is available in budget documents. Information on KPI that refer to sub-components as km of roads overhauled, km of roads that have been maintained, etc. is available in Passports of the State Programs and reports on their execution. Accounting Chambers' performance audit report on p.24-48 includes information on management mistakes with their influence on the execution of sub-components of the Program. Interesting fact is that State Road Agency published detailed geo-targeted data on the web portal of open data with the list of objects to be build and repaired in 2018. At the same time Ministry in Infrastructure cancels the report form that has been used for gathering data on the execution of road works.</p>
<p>4. Show how explanations are consistent with past experience or why conditions have changed. If A facts caused B deviation, is this result consistent with historical experience? If not, why not? A is a better explanation for B if evidence is provided that A normally (from past experience) causes B. For instance, if a particular change in the economy normally causes revenue to decline by a certain amount, it is a more convincing reason for the revenue decline now. If actual performance is not consistent with past experience, then some additional explanation for this fact is needed. Where conditions have changed, governments should also confirm that they will change their approach to forecasting in the future, or explain why not.</p>	<p>Inadequate</p>	<p>Lack of narrative on deviations and reason behind is very much consistent with the past practices as it is a common practice not to provide a good narrative. For example, Explanatory note of State Agency' Report on the Execution of State Budget 2017 has no information on underspending. Report of 2016 mentions that there were delays in approval of the "list of objects" by the Cabinet of Ministers and long procedures related to the opening of financing (State Treasury Service), which delayed the development of project documentation and issues with public procurement procedures. Lack of sufficient number of rolling stock of railway cars and locomotives for the transport of road construction materials, led to a significant reduction of performance in July-September of 2016, and in some areas to a complete stop of construction works. In Report of 2015 it was mentioned that one of the roads has not been completed and has not been put into operation due to the long duration of land allocation procedures for the construction site. In Report of 2014 only a fact of underfinancing is mentioned.</p>
<p>5.Explain the most important deviations. If X, Y, and Z are all major deviations from the budget, are explanations provided for all three? A government should explain all major budget deviations, rather than explaining only some or instead explaining minor deviations. Major deviations can be defined in terms of budget size, but also in terms of priority groups (e.g., the poor), or in terms of the non-financial impact of the deviations. The government will have to make and explain its</p>	<p>Inadequate</p>	<p>Very little or in most cases no attention is payed to publish narratives with explanations on deviations in road sector.</p>

judgement about what is a major deviation, or what are the most important deviations.		
6. Other considerations. Please use this space to evaluate the quality of the reasons provided by government according to any other standard you think relevant that is not covered above.	N/A	N/A