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Ukraine and the IMF

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August 29, 2014

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Ukraine: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

August 18, 2014

The following item is a Letter of Intent of the government of Ukraine, which describes the policies that Ukraine intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Ukraine, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent

Kyiv, August 18, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington DC, 20431

Dear Ms. Lagarde:

1. Our economic reform program aims at restoring macroeconomic stability, strengthening economic governance and transparency, and generating sound and sustainable economic growth, while protecting the most vulnerable. The attached Memorandum of Economic and Financial Policies (MEFP) updates the MEFP of April 22, 2014 to account for recent macroeconomic developments and introduce policy adjustments to continue the process of macroeconomic stabilization.

2. The economy continues to adjust, but a number of challenges have emerged since the inception of the program. The conflict in the East has intensified and is weighing heavily on confidence and the economic outlook. A dispute between Naftogaz and Gazprom over gas import prices, which has led to the cut of gas supplies by Gazprom, has added to the uncertainty. These developments are affecting economic activity, fiscal revenue performance, and balance of payment flows, making it difficult to meet the initial program targets for the months ahead.

3. We have been steadily implementing the policies under the program. All structural benchmarks for this review have been implemented, although some of them with delay. Despite the adverse impact of the continuing conflict in the Eastern part of the country on the economic situation, we have met all but one of the performance criteria (PCs) for end-May. With joint efforts of the NBU and the Ministry of Finance, we met the end-May PC on Net International Reserves (NIR). Strict control of budget expenditure allowed us to meet the PC on the general government deficit. However, since program approval, Naftogaz imported and stored more gas than initially assumed, which, together with a more depreciated exchange rate, led to a wider Naftogaz deficit. In light of this, the end-May PC on the combined general government/Naftogaz deficit was missed.

4. Similarly, we estimate that the end-July PCs on the general government deficit, guaranteed debt, and net domestic assets (NDA) have been met. However, reflecting the developments described above, the NIR and combined general government and Naftogaz deficit at end-July are estimated to have been missed. We are taking corrective actions to boost our reserve position and

to strengthen payment discipline and compliance, to partly offset these developments and ensure that future targets will be met.

5. In light of the existing economic pressures, we have recalibrated the fiscal deficit and international reserve paths targeted under the program, in a way that seeks to re-establish macroeconomic stability while avoiding undue strains on economic and social outcomes.

6. We remain determined to employ all the necessary measures to stabilize the economy, address structural weaknesses, and ensure sustainable growth. To ensure that the program remains fully financed and not subject to financing risks stemming from settling past gas import bills with Gazprom, we have set aside a substantial amount of funds to settle these bills, if and when such payments need to be made. Looking ahead, we will proceed with the implementation of the energy sector reform and restoration of the viability of Naftogaz finances. To this end, we will intensify our actions to improve collection of both current and past gas bills and make sure Naftogaz gets its fair share of customer payments in the heating sector. We are also committed to maintain a flexible exchange rate and introduce inflation targeting after careful preparation. Fiscal consolidation will continue, at a pace consistent with the economy's recovery trajectory. Simultaneously, we will work to preserve financial stability and continue strengthening our financial regulatory and supervisory framework. Structural reforms to address corruption, improve the business climate, and enhance the effectiveness of the judiciary will remain a key part of our reform agenda.

7. In light of our program implementation record, as well as the corrective actions put in place to avoid slippages on the Naftogaz deficit, boost reserves, and support the revised program targets, we request waivers of nonobservance of the end-July PCs on NIR and the combined general government/Naftogaz deficit and waivers of applicability of the end-July PCs on the ceiling on cash deficit of the general government, the ceiling on cumulative change in net domestic assets of the NBU and the ceiling on public guaranteed debt,—since final data to assess these are not yet available and we estimate they will have been met. On this basis, we also request the completion of the first review of the program under the Stand-By Arrangement and the associated disbursement of SDR 914.67 million. The domestic currency counterpart of Fund purchases in the amount of SDR 650 million will be used to finance the budget deficit. Given the delay in completing the first program review, we request the rephasing of disbursements under the Stand-By Arrangement. We request that the third and fourth purchases originally linked to the second and third reviews be consolidated and that the consolidated amount be made available in one purchase in mid-December 2014 subject to the completion of the second review on the basis of the observance of the end-September and continuous performance criteria.

8. We remain confident that the policies described in the current and previous MEFP are adequate to achieve the macroeconomic and financial objectives under the program. Nonetheless, we stand ready to take additional measures should they be needed to meet these objectives and will consult with the IMF, in accordance with the Fund's policies, on any necessary revisions to the policies contained in this letter and the attached MEFP. We will provide Fund staff with the data and information it requests for the purpose of monitoring program implementation. Reaffirming commitment to our policy of transparency, we consent to the IMF's publication of this letter, the attached MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents.

Yours sincerely,

/s/
Petro Poroshenko
President

/s/
Arsenii Yatseniuk
Prime Minister

/s/
Oleksandr Shlapak
Minister of Finance

/s/
Valeria Gontareva
Governor
National Bank of Ukraine

Memorandum of Economic and Financial Policies

I. Macroeconomic Framework

1. **Economic activity has been weakening, and escalation of the conflict in the East adds to the uncertainty**. In 2014:Q1, GDP dropped by a mild 1.1 percent, but high-frequency indicators point to a deepening recession. Although agricultural production is expanding, industrial production and construction have continued to decline and retail trade growth has decelerated. Accordingly, we revised our projections of the economic contraction in 2014 to -6.5 percent, from -5 percent expected at the time of our program request. In 2015, after the economy has stabilized, a rebound in exports, followed by private consumption and investment will lead to a modest recovery of 1 percent.

2. **The current account deficit is shrinking fast, but the overall balance of payments is not as good as expected**. While measures introduced by the NBU and the arrival of international financial assistance have reduced hryvnia volatility in April–July, recent intensification in security tensions have led to renewed exchange rate pressures. As a result, the exchange rate depreciated by about 55 percent by mid-August relative to end-2013. In light of this and the fall in domestic demand, imports have contracted rapidly. The current account deficit is in turn improving at a rapid pace and is now projected to reach 2.5 percent of GDP this year, compared to 4.4 percent at the time of the program request. Rollover rates for banks and corporate entities during the first five months of 2014 have been more robust than expected at the time of the program request. However, this has been more than offset by weaker FDI and larger than anticipated outflows of foreign currency from the banking system. On balance, these effects imply a lower than expected pace for accumulation of reserves under the program (Table 2).

3. **Consumer price inflation has accelerated, reflecting rapid pass-through from the currency depreciation and increases in administered prices**. The hryvnia exchange rate has been weaker than initially foreseen. As a result, we expect inflation to reach 19 percent by end-2014. In 2015, inflation should decelerate to about 9 percent, driven by a successful implementation of our stabilization policies.

II. Revised Policies under the program

A. Exchange Rate and Monetary Policy

4. **We remain committed to maintaining a flexible exchange rate**. To this end:

a. ***We will facilitate the unobstructed functioning of the FX market, and will make all regulations, rules, and procedures known and transparent to all market participants***. We have restored the temporarily suspended FX trading licenses to 22 banks in April–May 2014. We will resist pressures to modify legislation to widen the NBU's sanctioning powers with regard to the FX and money market, as this would create uncertainty among market participants and hamper the functioning of these markets.

b. ***We will gradually rescind existing restrictions and MCPs***. In May, we phased out the requirement to deposit hryvnia in a special account for several days before purchasing FX from the market. Once market pressures stemming from the current security tensions subside, we will formulate a plan for staged removal of the remaining restrictive measures, including exchange restrictions and multiple currency practices.

5. ***We remain committed to the objectives of maintaining adequate international reserves and controlling monetary aggregates***. In light of the less favorable BOP flows, we have revised the programmed NIR path (Table 2). To support the revised path, the NBU will accumulate at least US$1 billion through market purchases by end-2014. In this regard, by purchasing at least US$200 million, the NBU will achieve a level of NIR of at least US$7.675 billion as **a prior action**. To save reserves, the NBU will seek to limit FX sales to the central government and Naftogaz to the strictly necessary amounts factored into the program projections for 2014, and will not meet ad hoc demands for FX coming from local governments and other entities. Instead, the NBU will advise them to buy FX in the open market, as will Naftogaz—without restrictions—except for the one-off programmed purchases specified in the TMU (Table C). On its side, the Ministry of Finance will seek to roll over maturing domestic debt liabilities, both in hryvnia and FX by offering an appropriate interest rate and an expanded range of maturities. These policies will be followed throughout the program period. To secure achievement of NIR targets, the Debt Management Unit of the Ministry of Finance and the NBU Monetary Policy Department will step up coordination of their operations through the establishment of a high level coordinating committee. NBU liquidity provision and other operations with its counterparties will be based on a policy framework and regulations that are known and transparent to all market participants. To guide inflation expectations and enhance its

ability to control its net domestic assets as needed, the NBU will maintain its effective policy rate positive in real terms on a 12-month forward-looking basis.

6. **We will continue preparations for adopting inflation targeting (IT) in line with a detailed plan agreed with the IMF**. To this end, we will prepare a strategy to reform the central bank and monetary policy during both the transition phase and the steady state—when full-fledged inflation targeting will be in place**.**

a. ***A new monetary policy framework is currently being prepared***. This would mainly require an increase in the NBU policy and operational independence, building internal capacity, and establishing appropriate internal processes. Furthermore, the NBU will develop and use its own inflation projections and will no longer be obliged to follow the projections developed by the Ministry of Economy. To this end, the law on National Bank of Ukraine will be modified by end-November 2014.

b. ***Starting in July 2014, we will begin implementing changes in the internal NBU structure***. Specifically, we will set up a Monetary Policy Committee (MPC), and ensure a clear organizational and operational separation of the monetary policy formulation function in the Economics Department from the monetary policy implementation function in the context of the overall reorganization of the NBU structure based on the IMF TA Mission recommendations.

c. ***From July 2014 on, we will deploy a new communication strategy to convey to the public how the NBU operates***. The NBU will provide a clear public explanation of its monetary policy and operations, following the best practices established by other central banks.

d. ***The practice of NBU making advanced profit transfers to the budget will be discontinued from July 2014***. The NBU will not transfer profits during the second half of 2014, after the remaining amount of UAH 806 million from the 2013 profit will have been transferred. We will discontinue the practice of overriding the profit distribution rules included in the NBU Law by provisions in the annual Budget Laws and accordingly discontinue advance profit transfers from the NBU to the budget during the current fiscal year. To this end, we will enact legal amendments as needed.

e. ***Benefitting from the IMF technical assistance (TA), the NBU will move ahead with adopting market instruments for interest rate management and control***. As the outflow of deposits from the banking system is bottoming out, since end-July the liquidity support will mainly be focused at the standard monetary mechanisms and its cost will be closely linked to the policy rate.

f. ***By mid-2015, we plan to have in place all technical prerequisites for IT***. In particular, we will implement a transparent policy framework based on controlling money-market interest rates through open market operations using a key policy rate, supplemented by standing lending and deposit facilities.

B. Financial Sector Policies

7. **Despite the economic recession and political events in the Eastern provinces, the banking system has remained resilient**. All banks continue reporting capital adequacy ratios above the regulatory minimum of 10 percent as of end-June, and NPL levels have remained at about 14–15 percent since last May. Demand for fresh NBU liquidity support has eased in recent weeks, although 74 institutions are yet to reimburse NBU liquidity support. The Deposit Guarantee Fund has taken over 15 mainly small banks and has begun the process of paying out the insured deposits.

8. **We have already taken important steps towards maintaining banks' resilience, as envisaged in the program**. Specifically, (i) we reached agreement with IMF and WB staff on the terms of reference for the banks' diagnostic studies and, on this basis, launched the studies for the 15 largest banks in May 2014; (ii) we have amended the DGF Law to enhance its legal and operational capability to restructure banks; and (iii) the NBU and Ministry of Finance have agreed with IMF and WB staff on the criteria for using public funds in recapitalizing or restructuring eligible banks (structural benchmark for end-May, met with delay).

9. **We will continue making progress towards strengthening financial stability with a view to supporting economic growth**. This will be achieved by:

Updating the regulatory and supervisory framework

10. **We are working towards further enhancing our monitoring of banks**. While the bank diagnostics are being completed, the NBU' supervisory teams are actively monitoring and analyzing banking condition with the aim of identifying risks and banks in difficulties, classifying them in three categories (banks under ordinary regime, problematic, and insolvent) to decide on the supervisory strategy for each institution. Prudential supervision over problematic banks is performed on a daily basis, and this analysis together with detailed information on specific institution (including liquidity and cash flows analysis and quality and availability of collateral) is being reported to the NBU board weekly and serve as basis for the Board decision on disbursement of funds for new liquidity support or possible renewal of liquidity support loans. Importantly, with technical assistance from the IMF, we will complete by end-November 2014 a review of the NBU tools to identify problem banks early, by benchmarking them against best international practices. Finally, with the view to improve our

analysis and monitoring of systemic risks, by end-October we will enhance our set of modeling instruments for macro stress-testing.

Assessing financial resilience through bank diagnostics

11. **We will continue implementing diagnostic studies of banks**. By August 31, the NBU board will complete the review of the results of the diagnostic studies performed by external auditing firms on the largest fifteen banks and send letters to banks requiring recapitalization and submission of restructuring plans as a result of these studies (after taking into consideration recommendations provided by the Steering Committee responsible for controlling the quality of bank diagnostics). On July 15, 2014, the diagnostic studies of the 20 next largest banks have begun. By end-August, with technical assistance provided by IMF and WB, the NBU will prepare an outline of a standardized restructuring plan and a set of criteria to assess the credibility and sustainability of banks' recapitalization and restructuring plans.

Restructuring and recapitalizing financial institutions in need

12. **We are enhancing our preparedness to deal with eventual capital needs while preserving financial stability**. To this end, we are working on three fronts:

- **Enhancing the DGF framework and financial position**. We amended the DGF law to enhance its legal and operational capability to resolve banks by making more explicit the conditions of its access to public loans and direct recapitalization of the state in extreme circumstances. On funding, the amendments also allow the DGF to issue securities and exchange them with government securities to cover gaps between assets and liabilities that are being transferred from insolvent to solvent institutions. Moreover, on July 10, 2014 a cabinet resolution has been passed to rule on DGF funding activities. On the basis of estimates provided by the DGF and reviewed by the NBU and the Ministry of Finance, the latter will lend the DGF sufficient resources in line with the DGF Law to support its capability to pay out the insured deposits in the small banks it has taken over. By end-September 2014, in close coordination with IMF and WB staff we will issue the needed implementing by-laws to address new features introduced by the new DGF law.

- **Ensuring availability of contingent public funds**. With the advice of the Fund and WB, we have completed the criteria to use public funds to recapitalize and restructure systemically important banks. As in 2014, the government will continue to seek authorization to provide adequate public funds for this purpose in the 2015 budget.

- **Improving legal bank restructuring tools**. In close consultation with IMF and WB staff, we will submit by end-August draft legislation to Parliament to address legal weaknesses that may impede the effective implementation of the banking strategy agreed in the current program.

- **Enhancing coordination between NBU and DGF**. On the basis of their recently revised memorandum of understanding, the coordination between the two institutions has improved significantly. NBU and DGF staff are monitoring closely not only banks deemed to be insolvent but also problematic institutions.

13. **We will continue to ensure proper governance in restructuring banks**. We will take action in three fronts:

- **Monitoring state ownership in recapitalized banks**. We are working towards establishing a specialized unit to manage the state's financial sector shareholdings by end-September 2014. To this end, we will assess whether the current specialized division at the MoF, responsible for managing corporate rights, needs to be reorganized, enhancing its organizational relevance within the ministry, and provided with adequate budgetary resources to hire experienced staff. If action is needed, we will adopt the necessary measures by end-September 2014. Furthermore, while we believe the specialized division' current terms of reference could serve as the basis to define the relationship between banks and the Ministry of Finance and ensure no political interference, by end-August 2014, in coordination with Fund staff, we will revise our existing arrangement with the aim to identify any eventual deviation from international best practices.

- **Ensuring that due investigation is initialed**. The DGF has completed the filing of 112 potential cases of wrongdoing in the banks under its temporary administration, mostly associated with lack of control of bank assets and documentation. Furthermore, to enhance our work on governance, we will ensure that the DGF, in line with existing legislation and consultation with the IMF and WB staff, will complete by end-September 2014 terms of reference and an action plan to arrange comprehensive legal due diligence by independent firms of banks under temporary administration to identify whether wrongdoing or bad banking practices led the bank into insolvency. The tender process for the selection of the firms responsible for the due diligence of the first two cases of the action plan will be initiated by end-September 2014 with the view to launch the two such investigations by end-November 2014.

- **Managing the assets left in banks under liquidation**. With technical assistance from the IMF and WB, by end-November 2014 we will complete an assessment of options currently available and strategy to dispose assets with the aim to identify areas that may deserve further enhancement and help to maximize recovery value. This assessment will also include tools available to collect related party loans and means of cooperation from NBU (for example, NBU would ensure that in assessing these borrowers' creditworthiness the operating banks factor in past due loans held by banks under liquidation and also ensure these exposures are reported to the credit register set to be created at NBU). On this basis, we will amend the Law on banks and banking.

Enhancing banks' capacity to resolve bad loans

14. **We remain fully committed to ensuring that banks have the tools and motivation to successfully address their NPLs and proactively seek to prevent new ones**. To this end, we are working on four fronts:

- We will support the approval of legislation by end-September that would guide the restructuring of foreign currency denominated mortgage loans serviced by struggling but still performing borrowers without interfering in bilateral negotiations between borrowers and banks ***(structural benchmark)***. To this end, we will amend the draft law already passed by Parliament on first reading. This law will aim to: (i) protect the rights and interests of individuals that can demonstrate to be in financial difficulties; (ii) target borrowers with loans that do not exceed UAH 1 million as of end-December 2013 (about US$125,000) and who live in the mortgaged properties; (iii) establish a voluntary process where eligible borrowers would apply to banks for restructuring and can prove their difficult financial situation; (iv) guide banks to restructure loans on the basis of the borrowers' financial condition and capacity to pay. After considering reasonable living expenses, the banks will make a proposal to borrowers that may include debt conversion and interest and principal reduction; and (v) require banks to establish an independent and credible panel under NBU monitoring to deal with customers' complaints. This process will also be guided by the Code of Conduct discussed below. Should a materially different law be passed, the President will veto its enactment. Simultaneously, we will also lift the moratorium on collateral foreclosure imposed in June as it will be replicated for eligible borrowers by the procedures under the Code of Conduct.

- On the basis of NBU existing guidelines on loan in arrears and international best practice, with technical assistance from the IMF, the NBU will issue a Code of Conduct by mid-September 2014 to guide negotiations between borrowers in difficulty and banks, establish debt restructuring guidelines, and an appeal process. The Code will seek to induce fair and balanced negotiations between banks and borrowers. The launch of such negotiations will lead to immediate standstill on collateral foreclosure on residential property for eligible borrowers. The resulting agreements on debt workouts should aim to help borrowers in real need while maintaining a high level of debt servicing discipline.

- Supporting the introduction of the Code of Conduct, we will seek to amend the Tax Code by end-September 2014 to allow banks to deduct losses stemming from such debt workouts, while borrowers should not be required to recognize income associated with interest, penalties, and exchange rate differences stemming from debt restructuring.

- Going forward we also plan to enhance our current legal and regulatory framework associated with out of court arrangements and insolvency law, and ensure banks' readiness to deal with troubled borrowers, with technical assistance from the IMF.

C. Fiscal Policy

15. **The end-May general government deficit target was met, but pressures are emerging in light of the deterioration of the security situation**. Despite the positive effects of the measures implemented under the program and the depreciation of the hryvnia, tax revenues have been underperforming. Frontloading of the NBU profit transfer and expenditure restraint have helped meet the end-May target for the budget deficit with a wide margin. However, some accumulation of unpaid bills and reduction in VAT refunds could not be avoided. In addition, the deterioration of the security situation in the East is contributing to the recent weakness in tax revenue performance and creating upward pressures on military expenditure.

16. **In light of the shocks facing the economy, we are recalibrating our general government deficit path to maintain the targeted structural adjustment in the fiscal and quasi-fiscal deficit**. The recalibration aims at a larger structural fiscal adjustment of 2.6 percent of GDP during 2014–16, compared to the original program target of 2 percent, to compensate for the widening in Naftogaz's deficit (see section D). Given the weaker economy and the one-off nature of some of our military spending, this translates into headline general government deficits of 5.8 percent of GDP in 2014 (0.6 percent of GDP wider than envisaged at the time of the program request), 3.9 percent of GDP in 2015 (0.3 percent of GDP tighter than originally envisaged), and 2.7 percent of GDP in 2016 (0.4 percent of GDP tighter than originally envisaged). Since Naftogaz's projected operational deficit for 2014 also needs to be revised upwards (see below), this will be consistent with combined deficits of the general government and Naftogaz of 10.1 percent of GDP in 2014, 5.8 percent of GDP in 2015, and 4.0 percent of GDP in 2016. Revised ***quantitative performance criteria*** and indicative targets are set in Table 2.

17. **Notwithstanding the loosening of the 2014 general government deficit target, meeting the revised objective requires continuing spending restraint and additional policy measures**. First, we will maintain the expenditure policies described in the MEFP dated April 22—including refraining from discretionary wage, pension, and social assistance hikes as well as completing the significant cuts in administrative civil service staff (27,000 staff) to correct for an unaffordable expansion in previous years. Second, we will offset a UAH 9.7 billion increase in military and reconstruction spending planned in 2014 by reducing spending on goods and services, transfers, subsidies, and other expenditure by the same amount, including by locking in savings from the first half of the year. Third, we will implement additional revenue measures yielding UAH 5½ billion in the remainder of the year to partly compensate for the revenue shortfall driven by the deterioration of security in the East. To this end, in addition to the recently adopted tax on deposit interest income, we will extend the VAT exemption on grain exports from October to the end of 2014 and eliminate VAT exemptions for the wood-processing industry. A new supplementary budget reflecting these policy adjustments will be passed as ***a prior action***.

18. **Over the medium-term, we are aiming at a gradual expenditure-based fiscal consolidation to build confidence and reduce imbalances**. High levels of public spending relative to GDP call for an expenditure-led consolidation. We plan to implement a number of structural fiscal measures needed to meet our consolidation targets for 2015–16 and create fiscal space for growth-enhancing fiscal spending. Specifically:

- In 2015, we will continue our efforts to put expenditure on sustainable footing by further structural fiscal reforms while keeping discretionary spending in check. After a freeze in 2014, we plan to index public sector wages to expected inflation, while reducing the number of employees in the budgetary sector by 3 percent to limit the wage bill to 10.2 percent of GDP. Similarly, we will aim to maintain the purchasing power of pensions unchanged in real terms and target overall Pension Fund spending of 15.2 percent of GDP. Energy-saving measures and strict expenditure control will allow us to reduce spending on goods and services to 6.2 percent of GDP. These policies will allow us to expand public investment by almost half to 2 percent of GDP to support growth and cover reconstruction costs in the East.

- Building on the advice of the IMF technical assistance mission on expenditure rationalization, we will review by end-September 2014 the education spending and develop measures needed to enhance cost-efficiency in the sector, including by (i) exploring the possibility of raising class and school sizes toward the average European levels; and (ii) reducing excessive staffing on the basis of performance reviews. From July 1, 2015 we will also increase the teaching load of primary and secondary school teachers from 18 to 20 hours, followed by a further increase to 22 hours from

July 1, 2016. In addition, by end-September 2014 we will prepare a plan to introduce means-testing in providing benefits to students in secondary schools while protecting vulnerable groups as per our current plans.

- We have already begun to reform privileged pensions. From May 1, 2014, we reduced the replacement ratio used for calculating such pensions in the civil service from 80 to 70 percent and expanded the base of the pension to include the average wage of the last 5 years (as opposed to the last 2 years before). By end-September, we will prepare and present to IMF staff a plan of measures and legislative proposals to restrict eligibility for privileged pensions and reduce their cost over time. Specifically, we will keep privileged pensions at their current nominal levels until end-2015, except for inflation indexation of pensions that are at the subsistence minimum, and consider closing some of these systems for new entrants as part of the reform. The plan will also include expanding taxation of high-income pensioners in 2015. All these measures are expected to save the budget ¼ percent of GDP.

19. **Notwithstanding the priority given to the reduction in government spending in the years ahead, revenue reforms will also be necessary to achieve our fiscal objectives**.

- Drawing on recommendations of the recent FAD TA mission on tax administration, we will submit a law to Parliament by September 1, 2014 to be passed by end-October 2014 that will:

a. Eliminate discretion for large taxpayers to choose a tax office to manage their tax affairs and transfer all taxpayers meeting large taxpayer criteria to the Large Taxpayer Office;

b. Review the management of the largest debtors to the budget and assign the cases to a centralized and separate function starting from January 1, 2015.

- We will improve detection of under-declared wages, a pervasive problem, through strengthening risk-based assessment of taxpayers. To this end, we will assign the responsibility for improving compliance with payroll and PIT taxation to one deputy head in each local tax inspectorate. This person will lead the work to identify high-risk taxpayers—based on a set of indicators including a suspiciously high share of employees receiving minimum wage—and communicate this information to the tax police. Moreover, we will change the internal procedures of the fiscal service to enable the use of tax returns for identification of under-declared wages.

- After discussion within government and with the private sector, we will prepare by end-September 2014 a proposal for the reform of VAT in the agricultural sector in view of bringing the VAT treatment of this sector closer to the general VAT regime (***structural benchmark***). In this context, in consultation with producers we will reduce the VAT exemptions for agriculture in 2015. We are discussing with agricultural producers the most appropriate form of taxation taking into account the recommendations of IMF and World Bank technical assistance missions and the needs of the sector.

D. Energy Sector Policy

20. **Higher-than-planned gas imports and exchange rate depreciation have led to a sharper-than-expected deterioration of the Naftogaz deficit**. Naftogaz has imported and put in storage more gas than assumed at the time of the program request, which, together with the more depreciated exchange rate, has led to a wider deficit. Accordingly, and notwithstanding our full commitment to improve collections across all customer groups to ensure that future targets are met, we have had to revise the 2014 combined general government/Naftogaz deficit target upward, based on a projected deficit for Naftogaz of 4.3 percent of GDP versus 3.3 percent targeted earlier. In addition to the impact of the higher deficit, the company will need more support from the government than expected at the time of the program request (an additional 3.5 percent of GDP in 2014) to offset large shortfalls in the collection of past receivables due to inability of heating companies and some industrial companies to pay their bills. We are taking measures to address this problem (¶23).

21. **A gas price dispute with Gazprom led to accumulation of payment arrears in 2014:Q2, interruption of gas supplies in June, and an arbitration process under way in Stockholm**. Naftogaz has cleared its arrears for January–March 2014, leaving arrears for gas delivered in November and December 2013 outstanding. However, as the gas price is in dispute since April, Naftogaz did not pay for imported gas in April–June. Despite intensive negotiations, a solution was not found, and Gazprom stopped gas deliveries to Ukraine on June 16, 2014. Both companies filed arbitration claims, with Naftogaz claiming overpayment of US$6 billion for 2010–13 as a result of the gas prices charged by Gazprom then; the arbitrator's decision may affect the amount of arrears outstanding from 2013. More generally, Naftogaz is asking for revisions to the 2009 contract to reflect current economic conditions on the gas market and in Ukraine.

22. **We have made several important steps towards reforming the energy sector**.

- Household gas and heating tariffs were raised effective May 1 and July 1, 2014; industrial gas tariffs were adjusted in April and May to reflect exchange rate changes. The utility regulator

NURC remains committed to keeping the share flowing to Naftogaz constant rather that reducing it for the benefit of transportation and distribution companies.

- The new targeted social assistance scheme to offset the tariff increases for low income households became operational on July 1. Between the new and the existing schemes, about 27 percent of the population will receive assistance to cope with the energy bills.

- The audit company BDO was selected to conduct the quarterly cash flow audits of Naftogaz accounts and prepared the end-May cash flow audit on July 8 (a structural benchmark for end-June, met with delay).

- The process of making mandatory distribution accounts in the district heating sector fully operational is under way. These distribution accounts are critical for increasing the share of revenues channeled to Naftogaz from district heating companies once they collect revenues from consumers. The law on the creation of distribution accounts has been passed (a structural benchmark for end-June) and the Cabinet of Ministers resolution was published in early July. District heating companies are expected to open special bank accounts where households will deposit their bill payments within one month from the publication of the resolution. We expect that by the start of the heating season, the distribution accounts will be channeling to Naftogaz funds commensurate with the share of the gas price in the heating tariffs.

- In addition, as part of the reform in the energy sector, on June 4, 2014, we reiterated our objective to restructure Naftogaz by establishing separate companies that will perform the transit and storage of natural gas. This unbundling would put Ukraine in compliance with the Third Package of the Energy Community Treaty and would help attract investors for the modernization and operation of the gas transport system. In the coming months Parliament is expected to consider a number of legislative amendments to put this process into its implementation stage. A working group consisting of the European Commission and the World Bank is working with Naftogaz and the Ministry of Fuel and Energy in reforming the gas sector.

23. **Going forward, we remain committed to our energy sector reform strategy**:

a. ***In 2014, the main objective will be to contain Naftogaz's deficit to 4.3 percent of GDP***. We will reduce it to 1.9 percent of GDP in 2015 and aim to eliminate it by 2018.

b. ***To ensure that the program is not subject to financing risks stemming from settling past gas import bills with Gazprom, we have earmarked a substantial amount of funds for this purpose***. Specifically, after the completion of Naftogaz's recapitalization procedure, the company will deposit US$3.1 billion in a restricted account with the NBU (***prior action***). Naftogaz will make payments out of this account only with the agreement of the Ministry of Finance and the NBU for the purpose of settling gas bills with Gazprom upon a decision by the arbitrator in the dispute with Gazprom or if out of court settlement between Naftogaz and Gazprom is reached. In the event the funds in the account exceed the amounts needed to pay Gazprom under the arbitrator's decision or the settlement between the two companies, the funds will be used to pay for gas imports going forward.

c. ***In response to the developments noted above, the government will step up its financial support to Naftogaz***. In addition to the budget allocation of UAH 33 billion already put in place, Naftogaz will need UAH 82 billion to finance its deficit and its debt payment obligations. To this aim we amended the 2014 budget on July 31 to provide additional funds for Naftogaz recapitalization in the amount of UAH 70 billion, including UAH 7.3 billion to cover cancellation of arrears to Naftogaz related to tariff differences. In addition to enhancing its collection efforts, Naftogaz is in the process of rolling over domestic debt obligations coming due this year.

d. ***We will continue to adjust on a quarterly basis gas prices to industrial and budget consumers in line with the actual gas imports costs***, taking into account new gas import prices and exchange rate movements.

e. ***We will strengthen our efforts to collect Naftogaz receivables from clients, which is critical for improving Naftogaz finances***. To this end we have set up a working group involving the Ministry of Energy, Naftogaz, and the Ministry of Finance to review existing Naftogaz receivables and develop by end-August 2014 a monthly collection plan for September 2014–December 2015 (**structural benchmark**). The plan will have targets by customer category to maximize the collection of arrears and make sure that customers remain current with their bills. A department within Naftogaz will be tasked with assessing the stock of accounts receivable that are truly collectible, soliciting bill payments from collectible accounts, assessing the accounts on which a haircut is warranted in order to ensure at least a portion of the funds flows to Naftogaz, and blocking bank accounts and pursuing asset seizure if repayment or a plan for repayment is not agreed with customers. We will identify the necessary legal changes to remove obstacles, if any, to these collection methods by end-August 2014 and propose the necessary legislation amendments by September 15. Furthermore, Naftogaz will publish on its website the list of entities (private and public) with overdue bills payable for gas delivered to them. The list will be updated on a monthly basis.

f. ***We will continue to pursue our objectives of restructuring Naftogaz and attracting new investments in the gas sector***. We will amend relevant laws so as to allow FDI in companies operating in the gas transport and storage business. Furthermore, the statutes for the creation of two independent companies out of a Naftogaz subsidiary that will handle gas transport and storage services will be developed. Once these companies are operational, the procedures for setting tariffs for gas transport and storage will also be changed to reflect international best practice.

E. Governance, Transparency and the Business Climate

24. **Strengthening governance and the transparency of government operations and improving the business climate remain key reform priorities**. We have conducted jointly with Fund experts a diagnostic study (structural benchmark for July 15) to identify major areas for reforms. Based on the recommendations of the diagnostic study we will:

a. ***Improve governance and AML/CFT framework***. To this end we will:

- **Submit to Parliament by September 1, 2014 (*structural benchmark*) and adopt by end-October, 2014 (*structural benchmark*) enabling legislation for the establishment of an independent anti-corruption agency with broad investigative powers**. The agency will detect and investigate corruption offences and acts of the laundering of proceeds of corruption among high-level officials, as well as other corruption offences that constitute a particular danger to society and including those reflecting allegations received through a public hotline. The agency will prepare semi-annual public reports of its activities, including summary and data on its investigations and their outcomes. The agency will have powers of asset recovery (freezing, seizing and executing confiscation orders of assets) related to its own investigations. In particular, we will ensure that the agency will be: (i) operationally and institutionally independent from any external influence guaranteed and realized; (ii) accountable and transparent; (iii) adequately resourced in terms of budget, staffing and expertise; and (iv) able to obtain all relevant information domestically and to engage in international cooperation with regard to its area of competency. Institutional and operational independence from any external influence will be guaranteed and realized, in particular, through appropriate procedures for appointment; term limits and dismissal of the head of the agency; the power to recruit and dismiss its own staff; special procedures for budgetary allocations; and competitive remuneration for the head and staff of the agency. Prosecuting authorities will designate prosecutors to be in charge of prosecuting the cases under the jurisdiction of the agency; they will report to the Prosecutor General. Going forward, we will also implement reforms to strengthen the income and asset declaration, verification, and publication framework as it applies to high-level pubic officials. We will discuss this area of reforms with Fund staff at the time of subsequent reviews.

- **Submit to Parliament by September 1, 2014 (*structural benchmark*) and adopt by end-October, 2014 (*structural benchmark*) amendments to the AML law and the criminal code that will introduce key elements of the FATF standard to support the government's anti-corruption effort**. The key elements are as follows: (i) financial institutions will be required to conduct enhanced due diligence on business relationships with domestic politically exposed persons; (ii) the laundering of the proceeds of tax crimes will be criminalized and made a predicate offence to money laundering; (iii) the respective provisions of the Criminal Code of Ukraine pertaining to illicit enrichment will be brought in line with the UN Anticorruption Convention; (iv) financial institutions will be allowed to end a business relationship with a customer when institutions are unable to perform customer due diligence requirements; and (v) pecuniary administrative sanctions for non-compliance with AML requirements are effective, proportionate, and dissuasive.

b. ***Streamline the regulatory framework pertaining to economic activity***. To this end:

- **As a *prior action* for the review, the government will take a formal decision to establish by end-August an authorized body accountable to the Cabinet of Ministers to coordinate the effort to simplify regulations**. The head of the body will report directly to the Prime Minister to ensure adequate high-level coordination (both within the government and among government, civil society and business) as well as effective monitoring and reporting of progress toward regulatory simplification.

- **The government will adopt by end-October an action plan to streamline, simplify and clarify the legislative and regulatory frameworks governing economic activity (*structural benchmark*)**. The plan will be prepared by the coordinating body. Individual ministries and agencies will provide their input to the action plan based on their areas of competency. We will involve the business community and the civil society in a public consultative process. The action plan will include a census of existing legislative and regulatory requirements and specify those that will be eliminated, streamlined, simplified or clarified, with appropriate prioritization in terms of substantive impact and timelines. We will publish quarterly reports indicating the progress made on the action plan.

25. **Strengthen the effectiveness of the judiciary to ensure the enforcement of commercial claims**. Our reform agenda is based on four broad objectives: (i) enhancing judicial independence,

(ii) ensuring institutional integrity, (iii) streamlining organization and procedure, and (iv) strengthening post-court enforcement. We will develop, in consultation with Fund staff, specifics and timeline for reforms in these areas at the time of subsequent reviews. In the meantime, to lay the ground work, the relevant judicial entities (the State Judicial Administration and the High Council of Judges) and the State Enforcement Service have undertaken to conduct and complete by September 1, 2014, in consultation with IMF staff, reports on the following: (i) the number and processing time of court cases and post-court enforcement cases; (ii) the current court fee system (with revenue streams per jurisdiction) with proposals for changing court fees in line with cross-country developments; and (iii) the internal supervision system over judges and enforcement agents.

26. **Other steps to improve governance, transparency and fairness include**: (i) preparing, in consultation with the IMF and other international partners, a strategy by end-September 2014 and an implementation plan by end-November 2014 for strengthening tax compliance of high income earners and those with foreign assets; and (ii) continuing to address delays and weak transparency in granting VAT refunds, a long-standing problem that has given rise to governance issues. Regarding the VAT refunds, we remain committed to the specific measures outlined in MEFP of April 22, 2014. In particular, in order to step up VAT refunds, particularly those provided through the automated mechanism, we will reconsider the eligibility rule based on the level of average wages and will enhance the risk-based audit system. Appropriate amendments to the Tax Code will be introduced to this effect by end-October, following the recommendations of working groups established at the Ministry of Finance and involving representatives of the business community. Consistent with the Tax Code, the practice of requesting CIT advance payments in exchange for VAT refunds will be also prohibited—the State Tax Service will issue instructions to all tax offices to confirm this by end-July 2014.

III. Safeguards

27. **We will ensure that adequate safeguards are in place**. To this end, we will implement the recommendations of the IMF safeguards mission completed in May 2014 to improve the NBU governance and financial autonomy.

a. *The NBU will prepare in consultation with Fund staff draft legislative amendments to the NBU Law* (**structural benchmark for end-December 2014**). These will (i) strengthen the decision-making and oversight mandate of the Council; (ii) transform the Board into a smaller Executive Committee, composed of the Governor and Deputy Governors that would be charged with the residual powers of the NBU, which are powers not explicitly assigned to the Council or the Governor; (iii) strengthen the personal autonomy of Council members and Deputy Governors by enhancing appointment procedures and mitigating conflicts of interest through developing a

Code of Conduct; and (iv) authorize the Council to establish special reserves before the profit distribution rules kick in.

b. *We will strengthen internal controls of the NBU.* On May 8, 2014, the government and the NBU signed an Agreement concerning the servicing of future financial obligations related to the budget support under the current program and provided a copy of this Agreement to the Fund. We will resume the quarterly data audits introduced during the 2008 Fund-supported program and communicate the results to the Fund within six weeks of each test date. By October 2014 the NBU will establish a senior level Credit Committee to oversee the liquidity lending operations. In addition, the NBU will, in the medium term, shift the origination and management of these operations to a function outside of banking supervision.

c. *The government will settle its obligations to the NBU* which were accumulated (starting from February 2014) as the National Bank repaid out of its reserves the government obligations coming due to the IMF. These obligations covered by the NBU originated from budget support disbursements in the context of the 2010 SBA arrangement with the Fund. While repaying these obligations in full and on schedule, the NBU did not receive the corresponding payments from the Ministry of Finance (SDR 913 million in total). As per the Agreement signed between Ministry of Finance and the NBU in June 2014, the government will fully reimburse the NBU by end-2014.

IV. Program Monitoring

28. **Program implementation will be monitored through prior actions, quarterly reviews, quantitative performance criteria and indicative targets, and structural benchmarks**. The second review is now set for mid-December 2014 based on end-September 2014 quantitative targets and taking into consideration structural benchmarks through end-October 2014. For all reviews, quantitative performance criteria will include: a ceiling on the cash deficit of the general government; a ceiling on the combined deficits of the general government and Naftogaz; a ceiling on publicly guaranteed debt; a floor on cumulative change in the NIR; a ceiling on cumulative change in the NBU's NDA; and non-accumulation of external debt payments arrears by the general government. The **prior actions** and **structural benchmarks** are set out in Table 1. The quantitative targets for target dates through end-December 2014, along with a **continuous quantitative performance criterion** are set out in Table 2. The understandings between the Ukrainian authorities and IMF staff regarding the quantitative performance criteria and the structural measures described in this memorandum are further specified in the Technical Memorandum of Understanding (TMU) attached to this memorandum.

Table 1. Ukraine: Prior Actions and Structural Benchmarks

Prior actions	**Status**	**Completion date**
Parliament will pass a supplementary budget, reflecting: (i) the new tax policy and expenditure measures (¶17) and (ii) the funds necessary to recapitalize Naftogaz (¶23).	Met	July 31, 2014
The NBU will achieve a level of NIR of at least US$7.675 billion by accumulating at least US$200 million through market purchases (¶5).		
After the completion of Naftogaz's recapitalization procedure, the company will deposit US$3.1 billion in a restricted account with the NBU (¶23).		
The government will take a formal decision to establish by end-August an authorized body accountable to the Cabinet of Ministers to coordinate the effort to simplify regulations (¶24).		
Structural benchmarks	**Status**	**Completion date**
To strengthen payment discipline for the heating sector, Parliament will pass legislation that will make distribution accounts fully operational and mandatory for utility payments.	Met	June 30, 2014
If existing fit and proper shareholders are unwilling or incapable of recapitalizing in full a weak bank, public funds could be used to bring it back into solvency, according to strict criteria. Government and the NBU will reach agreement with IMF staff on these criteria.	Met with delay on July 4, 2014	May 31, 2014
To provide an accurate picture of Naftogaz finances, Naftogaz will launch a tender by April 3 to conduct audits of Naftogaz operations, led by an external auditor. The auditor will be in place within 60 days of the tender. The results of the audits will be shared with the IMF within 30 days of each period, initially on a monthly basis beginning with data for end-May 2014, and then on a quarterly basis for end-September data forward.	Met with delay on July 8, 2014	June 30, 2014 and then monthly through October; then quarterly
Complete a comprehensive diagnostic study in close consultation with IMF staff that will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on business climate, the effectiveness of the judiciary, and tax administration, as described in ¶24.	Met	July 15, 2014
Complete diagnostic studies and review of business plans for the 15 largest banks.	Met	July 31, 2014
The government should be prepared to manage its financial sector shareholdings in the event that it is called on to use public funds—and to this end, a specialized unit will be set up at the Finance Ministry.	In progress	September 30, 2014
After discussion within government and with the private sector, we will prepare a proposal for the reform of VAT in agriculture with a view to bringing the regime in this sector closer to the general VAT regime.	In progress	September 30, 2014

Table 1. Ukraine: Prior Actions and Structural Benchmarks (concluded)

Structural benchmarks	**Status**	**Completion date**
Prepare a monthly collection plan for Naftogaz's receivables for September 2014–December 2015, with targets by customer group.	**New SB**	End-August, 2014
Parliament will adopt a law to facilitate NPL resolution and help prevent new NPLs, as described in ¶14.	**New SB**	End-September, 2014
Submit to Parliament draft law for the establishment of an independent anti-corruption agency with broad investigative powers	**New SB**	September 1, 2014
Adopt enabling legislation for the establishment of an independent anti-corruption agency with broad investigative powers.	**New SB**	End-October, 2014
Submit to Parliament amendments to the AML law and the criminal code that will introduce key elements of the FATF standard to support the government's anti-corruption effort.	**New SB**	September 1, 2014
Adopt amendments to the AML law and the criminal code that will introduce key elements of the FATF standard to support the government's anti-corruption effort.	**New SB**	End-October, 2014
The government will adopt an action plan to eliminate, streamline, simplify and clarify the legislative and regulatory frameworks governing economic activity.	**New SB**	End-October, 2014
The NBU will prepare draft legislative amendments to the NBU Law to strengthen the governance and autonomy framework of the NBU, in line with the recommendations of the safeguards assessment mission.	**New SB**	End-December, 2014

Table 2. Ukraine: Quantitative Program Targets and Projected Performance 1/

(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

	2014										
	March	May			July			September		December	
		PC	Adj. PC		PC	Adj. PC	Est.	IT	PC	IT	PC
I. Quantitative performance criteria											
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	4,732	31,000	25,211	5,193	47,500	36,252	34,000	59,000	64,000	78,000	88,000
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	4,685	44,700	10,371	14,791	69,200	3,895	48,700	94,800	130,305	128,500	153,349
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	10,998	-1,273	849.0	849.0	1,096	311	-223	266	-3,780	-687	-3,755
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	208,588	36,383	14,523	4,611	21,292	39,379	31,082	29,685	83,638	51,527	104,349
Ceiling on publicly guaranteed debt 2/	0	25,000		0	25,000		0	25,000	25,000	25,000	25,000
II. Continuous performance criterion											
Non-accumulation of new external debt payments arrears by the general government 2/	0	0		0	0		0	0	0	0	0
III. Indicative Targets											
Ceiling on cumulative change in base money 3/	329,061	22,438		13,912	33,303	38,503	28,645	32,593	42,233	44,003	63,211
Ceiling on net accumulation of VAT refund arrears 5/	8,545	0		2,150	0			-2,500	-5,000	-5,000	-10,695
IV. Memorandum Items											
External project financing 2/	317	2,800		414	5,000		1,300	15,500	2,300	31,400	4,700
NBU loans to DGF and operations with Government bonds issued for DGF financing or banks recapitalization 3/	0	0		0	0		5,200	0	5,200	15,000	28,700
Government bonds issued for banks recapitalization and DGF financing 3/	0	0		0	0		0	0	0	15,000	23,500
Stock of budgetary arrears on social payments 2/	0	0		21	0		0	0	0	0	0
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	29	1,150		1,898	4,746		2,587	5,786	5,544	6,286	6,826
Percent of it applied to adjustment	...	100		100	100		100	75	100	75	100
Naftogaz purchases of foreign exchange from the NBU for the purposes and in the event of paying gas supply bills and repaying currently disputed arrears to Gazprom as well as the Eurobond issue maturing in September 2014 (millions of US dollars) 3/	813	2,160		786	2,160		786	3,830	5,556	4,830	6,935
NBU purchases of T-bonds Issued by Government for Naftogaz recapitalization 3/	11,100	23,662		10,000	23,662		12,900	41,956	75,100	52,911	104,400
Financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects 2/	0	0		0	0		0	0	0	0	0
Net transfers made by Gazprom (advance transit fee) 2/	0	0		0	0		0	0	0	0	0
Estimated arrears to Gazprom for gas imports (millions of U.S. dollars) 6/ 7/	2,238	0		2,449	0		4,469	0	4,469	0	0
Ceiling on bonds issued to pay VAT refund arrears (VAT bonds) 2/	0	16,700		0	16,700		5,800	16,700	16,700	16,700	16,700
Program exchange rate, Hryvnia per U.S. dollar	10.9546	10.9546		10.9546	10.9546		10.9546	10.9546	10.9546	10.9546	10.9546

Sources: Ukrainian authorities; and IMF staff estimates and projections.

1/ Definitions and adjustors are specified in the Technical Memorandum of Understanding (TMU).

2/ Targets and projections are cumulative flows from end-December, 2013. Data for March are flows from end-December, 2013.

3/ Targets and projections are cumulative flows from April 1, 2014. Data for March are stocks as of end-March, 2014.

4/ Calculated using program exchange rates specified in the TMU.

5/ Data for March is a stock as of the end of the month. The flows for May and July are cumulative from end-March 2014. Targets for September and December are cumulative flows from end-May 2014.

6/ Naftogaz is currently disputing the arrears to Gazprom. The estimates of potential liabilities arising from such disputed arrears are provided solely for the purpose of accounting for program financing and risk assessment considerations.

7/ Arrears stock data for end-March, end-May, end-July include arrears for gas imports in 2013 and for imports up to end-March 2014, end-April, and end-June respectively. Arrears for end-September program targets are the sum of unpaid bills from January 2014 (US$3.759 billion).

Technical Memorandum of Understanding

August 18, 2014

1. This Technical Memorandum of Understanding (TMU) replaces the TMU of April 22, 2014 and sets out the understandings between the Ukrainian authorities and IMF staff regarding the definitions of the variables subject to quantitative targets (performance criteria and indicative targets) for the economic program supported under the Stand-By Arrangement, as described in the authorities' Letter of Intent (LOI) dated August 18, 2014 and the attached Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. As is standard under all Fund arrangements, we will consult with the Fund before modifying measures contained in the LOI, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.

2. The quantitative performance criteria are shown in Table 2 of the MEFP. The definitions of these quantitative targets and the adjustment mechanisms are described in Section I below. Prior actions and structural benchmarks are listed in Table 1 of the MEFP, with corresponding definitions in Section I below. The official exchange rate is defined in Section II. Reporting requirements are specified in Section III.

3. For the purposes of the program, all exchange rates used to evaluate reserve levels and monetary aggregates are (i) the official exchange rate of the Ukrainian hryvnia to the U.S. dollar of 10.9546 set by the NBU as of March 31, 2014, and (ii) reference exchange rates of foreign currencies reported by the European Central Bank (ECB) on its web site as of March 28, 2014, which the NBU used to set official exchange rates of hryvnia to those currencies. In particular, the Swiss Franc is valued at 0.8857 per dollar, the Euro is valued at 1.3759 dollars, Pound Sterling is valued at1.6633 dollars, Australian dollar is valued at 0.9243 U.S. dollars, and the Japanese yen is valued at 102.41 per dollar. The accounting exchange rate for the SDR will be 0.647773 per dollar. Official gold holdings were valued at 1,295.75 dollars per fine ounce. These program exchange rates are kept fixed over the program period. Therefore, the program exchange rate differs from the actual exchange rate set in the foreign exchange market. Furthermore, setting a program exchange rate for the purpose of computing monetary aggregates does not imply that there is any target exchange rate for policy purposes.

4. For the purpose of the program, gross domestic product is compiled as per the System of National Accounts 1993 (SNA'93). The State Statistics Service has indicated that they plan to change to the System of National Accounts 2008 and discontinue the series based on SNA'93 at some point in 2014. We will reach agreement with the Fund before making any modifications in GDP compilation used for purposes of the program.

I. Quantitative Performance Criteria, Indicative Ceilings, and Continuous Performance Criteria

A. Floor on Cumulative Change in Net International Reserves (Performance Criterion)

Definition

5. Net international reserves (NIR) of the NBU are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities to nonresidents, evaluated at program exchange rates.

6. Usable gross international reserves comprise all readily available claims on nonresidents denominated in convertible foreign currencies, consistent with the Balance of Payments Manual (Fifth Edition) and the Special Data Dissemination Standard (SDDS) (Table A, item 1). Excluded from usable reserves, *inter alia*, are:

- any assets denominated in foreign currencies held at, or which are claims on, domestic institutions (i.e., institutions headquartered domestically, but located either domestically or abroad, or institutions headquartered abroad, but located domestically). Also excluded are all foreign currency claims of the NBU on domestic banks, and NBU deposits held at the Interbank Foreign Currency Exchange Market and domestic banks for trading purposes;

- any precious metals or metal deposits, other than monetary gold and gold deposits, held by the NBU;

- any assets that correspond to claims of commercial banks in foreign currency on the NBU and any reserves assets that are: (i) encumbered; or (ii) pledged as collateral (in so far as not already included in foreign liabilities, or excluded from reserve assets); or (iii) frozen; and

- any reserve assets that are not readily available for intervention in the foreign exchange market, *inter alia*, because of lack of quality or lack of liquidity that limits marketability at the book price.

7. For the purpose of this program, reserve-related liabilities comprise:

- all short-term liabilities of the NBU vis-à-vis nonresidents with an original maturity of one year or less;

- the stock of IMF credit outstanding;

- the nominal value of all derivative positions[1] (including swaps, options, forwards, and futures) of the NBU and general government, implying the sale of foreign currency or other reserve assets against domestic currency; and
- all foreign exchange liabilities of the NBU to resident entities (e.g., claims in foreign exchange of domestic banks, and NBU credits in foreign exchange from domestic market) excluding foreign exchange liabilities to the general government, or related to deposit guarantees.

Table A. Components of Net International Reserves

Type of Foreign Reserve Asset or Liability[2]	NBU Balance Sheet and memorandum Accounts
1. **International reserves**	
Monetary gold	1100, 1107
Foreign exchange in cash	1011, 1017
Demand deposits at foreign banks	1201, 1202,
Short-term time deposits at foreign banks	1211,
Long-term deposits at foreign banksSDR holdings and Reserve	1212
Position in the IMF	IMF, Finance Department[3]
Securities issued by nonresidents	1300, 1305, 1307, 1308, minus 1306
Settlement of foreign securities	2746, minus 4746
2. **Short-term liabilities to nonresidents** *(in convertible currencies)*	
Correspondent accounts of nonresident banks	3201
Short-term deposits of nonresident banks	3211
Operations with nonresident customersUse of IMF credit	3230, 3232, 3233IMF, Finance Department

[1] This refers to the notional value of the commitments, not the market value.

[2] The definitions used in this technical memorandum will be adjusted to reflect any changes in accounting classifications introduced during the period of the program. The definitions of the foreign accounts here correspond to the system of accounts in existence on March 31, 2014. The authorities will inform the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, and changes in the reporting forms.

[3] Before receiving the monthly data from the IMF's Finance Department, these components will be calculated on the basis of preliminary data from the NBU and memorandum accounts.

Adjustment mechanism

- The NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B). Program disbursements are defined as external disbursements (excluding project financing disbursements) from official multilateral creditors (World Bank, European Commission, European Investment Bank, and European Bank for Reconstruction and Development), official bilateral creditors (net), and external bond placements that are usable for the financing of the central government budget.

- NIR targets will be adjusted upward by the full amount of the cumulative shortfall in Naftogaz purchases of foreign exchange from the NBU for the purposes and in the event of paying gas supply bills and repaying currently disputed arrears to Gazprom (including by depositing funds in a restricted account) as well as the Eurobond issue maturing in September 2014 relative to the baseline projection (Table C).[4]

- NIR targets will be adjusted upward by the full amount of the cumulative shortfall in government purchases of foreign exchange from the NBU for the purpose and in the event of early repayment of government-guaranteed part of the maturing external loan to Naftogaz (in case this loan is repaid ahead of schedule). The upward adjustment of the NIR target will be capped to US$500 million.

[4] Naftogaz is currently disputing the arrears to Gazprom. The estimates of potential liabilities arising from such disputed arrears are provided solely for the purpose of accounting for program financing and risk assessment considerations.

Table B. Eurobond Placements and Disbursements from IFIs and Official Sources: Projections for NIR/NDA Adjustment

(Cumulative flows from end-March 2014, millions of US dollars at program exchange rate)

	Eurobond placement	World Bank	EU	EBRD	EIB	Others (Canada, Japan)	**Total**
End- May 2014	1000	760.6	137.6	0	0	0	**1,898.2**
End-July 2014	1,000	761	826	0	0	0	**2,587**
End-September 2014	3,000	1,261	1,183	0	0	100	**5,544**
End-December 2014	3,000	1,511	2,215	0	0	100	**6,826**

Table C. Naftogaz Purchases of Foreign Exchange from NBU: Projections for NIR/NDA Adjustment

(Cumulative flows from end-March 2014)

	Naftogaz purchases of foreign exchange from the NBU for the purposes and in the event of paying gas supply bills and repaying currently disputed arrears to Gazprom as well as the Eurobond issue maturing in September 2014 (millions of U.S. dollars) [5]	NBU purchases of T-bonds issued by Government for Naftogaz recapitalization (millions of hryvnia)
End-May 2014	**786.4**	**10,000**
End-July 2014	**786.4**	**12,900**
End-September 2014	**5,556**	**75,100**
End-December 2014	**6,935**	**104,400**

[5] As the arrears and their size are currently disputed the estimates are tentative and provided for program financing and risks assessment purposes only.

B. Ceiling on Cumulative Change in Net Domestic Assets of the NBU (Performance Criterion)

Definition

8. Net domestic assets (NDA) of the NBU are defined as the difference between the monetary base (as defined below) and the NIR of Ukraine (as defined above). For the purpose of computing the NDA target, the NIR is valued at the program exchange rate defined in paragraph 3 and expressed in hryvnia.

Adjustment mechanism

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B) and evaluated at the program exchange rate.

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward by the full amount of the cumulative shortfall in NBU purchases of T-bonds issued by Government for Naftogaz recapitalization for the purposes and in the event of paying gas supply bills and repaying currently disputed arrears to Gazprom [6] (including by depositing funds in a restricted account) as well as the Eurobond issue maturing in September 2014 relative to the baseline projection (Table C).

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward by the hryvnia equivalent of the full amount of the cumulative shortfall in government purchases of foreign exchange from the NBU for the purpose of repaying government-guaranteed part of the maturing external loan to Naftogaz (in case this loan is repaid ahead of schedule). The downward adjustment of the NIR target will be capped to hryvnia equivalent of US$500 million, calculated using the program exchange rate defined in paragraph 3.

- NDA targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing, and NBU purchases of government bonds issued (up to a limit of UAH 15 billion) for bank recapitalization, relative to the baseline projection (Table D).

[6] See footnote 4.

Table D. NBU Loans to DGF and Operations with Government Bonds Issued for DGF Financing or Banks Recapitalization: Projections for NDA/Monetary Base Adjustment

(Cumulative flows from end-March 2014, millions of hryvnia)

	NBU operations with Government bonds issued for DGF financing and banks recapitalization	NBU loans to DGF	**Total**
End-May 2014	0.0	0.0	**0.0**
End-July 2014	0.0	5,200	**5,200**
End-September 2014	0.0	5,200	**5,200**
End-December 2014	23,500	5,200	**28,700**

C. Ceiling on Cumulative Change in Monetary Base of the NBU (Base Money) (Indicative Target)

Definition

9. The NBU's monetary base comprises domestic currency outside banks and banks' reserves, including cash in vault of commercial banks,[7] and funds of customers at the NBU. Currency outside banks is defined as: Currency—banknotes and coins—(NBU accounts 3000 (net)+3001 (net)-3007A-3009A-1001A-1004A-1007A-1008A-1009A) minus cash in vault at deposit money banks (DMBs) (DMB accounts 1001A:1005A, and 1007A). Banks' reserves are defined as: cash in vault at deposit money banks (DMB accounts 1001A:1005A, and 1007A) plus DMB correspondent account deposits at the NBU in hryvnia (NBU liabilities accounts 3200, 3203, 3204, and 3206) plus funds of customers at the NBU in hryvnia (NBU liabilities accounts of groups 323[8], 3250, 4731, 4732, 4735, 4736, 4738, 4739, and 4750), plus accrued interest on time deposits of DMBs in national currency (NBU accounts 3208L), plus accrued interest on client's current accounts in national currency.

[7] The definitions set out here will be modified to include any other accounts that may be identified or created in the future in connection with domestic currency issue and the deposit money banks' deposits at the NBU.

[8] Includes accounts of following sectors: 2 – other financial intermediaries and other financial organizations; 6 – regional and local authorities; 7 – government non-financial corporations; 8 – private and foreign-controlled non-financial corporations; 9 – non-commercial organizations serving households.

Adjustment mechanism

- Consistent with the NDA target adjustment mechanism (as defined above), monetary base targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing or banks recapitalization (up to a limit of UAH 15 billion for purposes of recapitalization), relative to the baseline projection (Table D), and evaluated at the program exchange rate if provided in foreign exchange.

D. Ceiling on Cash Deficit of the General Government (Performance Criterion)

Definition

10. The general government comprises the central (state) government, including the Road Fund (UkrAvtoDor), all local governments, and all extra budgetary funds, including the Pension, Unemployment Insurance, Temporary Disability Insurance, Occupational Injury and Disease Insurance Funds. The budget of the general government comprises: (i) the state budget; (ii) all local government budgets; and (iii), if not already included in (i), the budgets of the extra budgetary funds listed above, as well as any other extra budgetary funds included in the monetary statistics compiled by the NBU. The government will inform the IMF staff of the creation or any pending reclassification of any new funds, programs, or entities, immediately. The cash deficit of the general government is measured by means of net financing flows as:

- total net treasury bill sales[9] (in hryvnias and foreign currency) as measured by the information kept in the NBU registry of treasury bill sales (net treasury bill sales are defined as the cumulative total funds realized from the sales of treasury bills at the primary auction and Government securities issued for recapitalization of banks and SOEs, less the cumulative total redemption of principal on treasury bills), excluding bonds issued to recapitalize Naftogaz[10] and other SOEs, banks and DGF; plus

- other net domestic banking system credit to general government as measured by the monetary statistics provided by the NBU (this consists of all non-treasury-bill financing in either domestic or foreign currency extended to the general government by banks less the change in all

[9] From here on, treasury bills are defined as all treasury securities (including long term instruments or treasury bonds).

[10] These are included in the calculation of Naftogaz' cash deficit when they are used (as collateral for a loan, or as an outright sale) by the latter to obtain financing.

government deposits in the banking system) as well as any other financing extended by entities not reflected by the monetary statistics provided by the NBU; plus

- total receipts from privatization received by the State Property Fund and local governments (including the change in the stock of refundable participation deposits); plus
- the difference between disbursements and amortization on any bond issued by the general government or the NBU to nonresidents for purposes of financing the deficit of the general government; plus
- the difference between disbursements of foreign credits to the general government (including project loans on-lent to public enterprises) and the amortization of foreign credits by the general government (including on lent project loans); plus
- the net sales of SDR allocation in the SDR department; plus
- the net change in general government deposits in nonresident banks, or other nonresident institutions; plus
- net proceeds from any promissory note or other financial instruments issued by the general government.

11. For the purposes of measuring the deficit of the general government, all flows to/from the budget in foreign currency (including from the issuance of foreign currency denominated domestic financial instruments) will be accounted in hryvnias at the official exchange rate established as of the date of the transaction.

Adjustment mechanism

- The ceiling on the cash deficit of the general government is subject to an automatic adjuster based on deviations of external project financing (defined as disbursements from bilateral and multilateral creditors to the consolidated general government for specific project expenditure) from program projections (Table E). Specifically, if the cumulative proceeds from external project financing (in hryvnia evaluated at actual exchange rates):

a) exceed program projections, the ceiling on the consolidated general government deficit will be adjusted upward by 100 percent of the excess in external project financing; and

b) fall short of program projections, the ceiling on the consolidated general government deficit will be adjusted downward by 100 percent of the shortfall in external project financing.

Table E. External Financing of General Government Projects—Adjustment

Cumulative flows from January 1, 2014	In millions of hryvnia
External project financing (technical assumption for the adjuster purpose)	
End-May 2014	414
End-July 2014	1,300
End-September 2014	2,300
End-December 2014	4,700

- The ceilings on the cash deficit of the general government at end-May, end-July, end-September, and end-December 2014 are subject to an automatic adjuster corresponding to the full amount of NBU purchases of government bonds issued for the purposes of DGF financing (excluding subsequent interest payments on the securities or other instruments issued). These ceilings are also subject to an automatic adjuster corresponding to the amount of NBU purchases of government bonds issued for the purposes of banks recapitalization and DGF financing, up to a cumulative maximum of UAH 23.5 billion in 2014. The test date ceilings on the cash deficit of the general government for 2015 will be adjusted upward by any amount of the UAH 23.5 billion bank recapitalization and DGF financing ceiling under the program that is not used in 2014.

- The ceiling on the cash deficit of the general government is subject to an automatic adjuster on the stock of budgetary arrears on social payments. Budgetary arrears on social payments comprise all arrears of the consolidated budget on wages, pensions, and social benefits owed by the Pension Fund, and the central or local governments. Budgetary arrears are defined as payments not made thirty days after they are due. Wages are defined to comprise all forms of remuneration for work performed for standard and overtime work. Pension obligations of the Pension Fund comprise all pension benefits and other obligations of the Pension Fund.

- The ceilings on the cash deficit of the general government at end-May, end-July, end-September, and end-December 2014 are subject to an automatic upward adjustment for the full amount of bonds used to pay VAT refund arrears (VAT bonds) accumulated before January 1, 2014, and will be limited to no more than UAH 16.7 billion cumulatively during 2014. No such bonds will be issued in 2015 or later, and therefore there is no such adjustment for the other test dates. The ceiling on the cash deficit of the general government at all other 2014 test dates will be automatically adjusted downward by VAT refund arrears accumulated in excess of ceilings defined in Section E from January 1, 2014.

- The ceilings on the cash deficit of the general government at end-July, end-September, and end-December 2014 are subject to an upward adjustment for the full amount of Government repaying government-guaranteed part of an external loan to Naftogaz, in case this loan is repaid ahead of schedule and the repayment is recorded as above-the-line transaction. The adjustment will be equal to the actually repaid amount in US$ terms capped at US$500 million, and recalculated in hryvnia at the actual exchange rate at the time of repayment.

E. Ceiling on VAT Refund Arrears (Indicative Target)

12. The ceiling on net accumulation of VAT refund arrears is set to UAH 5.3 billion at end-July 2014, UAH 2.8 billion at end-September 2014, and UAH 0 billion at end-December 2014. The stock of VAT refund arrears is defined as those claims that have not been settled (through a cash refund, netting out against obligations of taxpayers, payment with a government bond (VAT bond) or an official decision to reject the claim) within a specified time period after the VAT refund claim has been submitted to the State Fiscal Service (SFS). In 2014, this time period is 74 days, allowing for verification of the validity and payment processing of claims. According to this definition, the stock of VAT refund arrears as of December 31, 2013 was UAH 16.7 billion and UAH 18.3 billion as of March 31, 2014.

F. Ceiling on Cash Deficit of the General Government and Naftogaz (Performance Criterion)

Definition

13. The cash deficit of the General Government and Naftogaz is the cash deficit of the General Government as defined above plus the cash deficit of Naftogaz.

14. Naftogaz is defined as the national joint stock company “Naftogaz of Ukraine.” The cash deficit of Naftogaz is measured from below the line as:

- net domestic banking system credit to the company (this consists of all financing in either domestic or foreign currency extended to the company by banks less the change in company deposits in the banking system); plus

- the difference between disbursements of private foreign loans to Naftogaz (including private placements) and the amortization of private foreign loans (including private placements) ; plus
- the difference between disbursements of official foreign credits to Naftogaz (including project loans) and the amortization of official foreign credits (including project loans); plus
- the disbursements of trade credits from Gazprom to import gas; plus
- the difference between disbursements and amortization on any bonds issued by Naftogaz; plus
- the net change in deposits of Naftogaz in nonresident banks, or other nonresident institutions; plus
- net proceeds from any promissory note or other financial instruments issued by Naftogaz; plus
- net receipts from sale of financial assets (including recapitalization or other form of treasury securities issued to Naftogaz, irrespective of their issuance date); plus
- any other forms of financing of the company not identified above.

15. For the purposes of measuring the deficit of Naftogaz, all flows in foreign currency will be accounted in hryvnias at the official exchange rate as of the date of the transaction. When there are arrears outstanding as of the test date, the official exchange rate on the test date will apply to their valuation.

Adjustment mechanism

- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted upward by the amount of financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the net transfers made by Gazprom (advance transit fee). These transfers are measured on a cumulative basis from the beginning of each calendar year.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the cumulative amount of net arrears to Gazprom in 2014. [11] Gas imports bills are

[11] See footnote 4.

considered arrears the day after their payment is due (7th day of the subsequent month of imports). The arrears for imported gas will be valued at the gas price agreed between Naftogaz and Gazprom if such an agreement is reached, or based on the Stockholm Arbitration ruling. In the absence of an agreed gas price, or the price determined based on the Stockholm Arbitration ruling, a program accounting price will apply to arrears valuation. This price is used for accounting purpose only, and does not constitute an expression of a view by Fund staff on what the gas price should be.

G. Ceiling on Non-Accumulation of New External Debt Payments Arrears by the General Government (Continuous Performance Criterion)

Definition

16. For the purposes of the program, an external debt payment arrear will be defined as a payment by the general government, which has not been made within seven days after falling due (including grace period, if any). The performance criterion will apply on a continuous basis throughout the program period.

H. Ceiling on Publicly Guaranteed Debt (Performance Criterion)

Definition

17. The ceiling on publicly guaranteed debt will apply to the amount of guarantees issued in 2014 by the central (state) government. The official exchange rate will apply to all non-UAH denominated debt. New state guarantees in 2014 will amount to no more than UAH 25 billion.

I. Other Continuous Performance Criteria

18. During the period of the Stand-By Arrangement, Ukraine will not (i) impose or intensify restrictions on the making of payments and transfers for current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payments agreements that are inconsistent with Article VIII; and (iv) impose or intensify import restrictions for balance of payments reasons.

II. Official Exchange Rate

Determination of the official exchange rate

19. The NBU will, on a daily basis, set the official rate calculated as a weighted average of rates on the same day's interbank market transactions. NBU will make public its official exchange rate by no later than 16:00 of the day for which it is set.

III. Reporting Requirements

A. National Bank of Ukraine

20. The NBU will continue to provide to the IMF on a monthly basis, no later than the 25th day of the following month, an aggregate balance sheet for the NBU and a consolidated balance sheet for the deposit money banks.

21. The NBU will provide to the IMF, on a weekly basis, with daily data the stock of net and gross international reserves, at both actual and program exchange rates. In addition, it will provide on a weekly and monthly basis, no later than the 25th of the following month, the full breakdown of NBU accounts included in net international reserves (defined in Table A above).

22. The NBU will provide the IMF on a daily basis with information on official foreign exchange interventions. In this context, it will also provide the results of any foreign exchange auctions.

23. The NBU will provide the IMF on a daily basis with information on balances held in the analytical accounts 2900 "Accounts payable per transactions for the foreign exchange, banking and precious metals purchase and sale on behalf of banks' clients".

24. The NBU will continue to provide on its web site the daily holdings of treasury bills at primary market prices, at current exchange rates. The NBU will provide information on daily holdings of treasury bills broken down by type of holders (including state-owned banks and private banks) at primary market prices at the rate fixed on the day of auction information on t-bills sales, including in the foreign exchange, from the beginning of the year at the official rate as of the date of placement, as well as the t-bills in circulation, by principal debt outstanding at the official exchange rate as of the date of placement (OP-2); reports on each treasury bill auction; and provide to the IMF the monthly report on treasury bills, in the format agreed with the IMF staff.

25. The NBU will provide information on daily transactions (volumes and yields) on the secondary market treasury bills (including over the counter transactions).

26. The NBU will provide to the IMF, on a daily basis, the information on the banks' claims on the loans provided and liabilities in the format agreed with the IMF staff.

27. The NBU will keep providing to the IMF, on a monthly basis, general information on the NBU financing (as well as the refinancing) of the banks of Ukraine, and on the operations of mopping up (absorption) of the liquidity from the banking system (including through the CDs issuance) in the format agreed with the IMF staff. It will also provide, on a weekly basis, bank-by-bank information on the Ukrainian banking system's debt on credits received from the NBU.

28. The NBU will provide to the IMF, on a quarterly basis but not later than 30 days after the expiration of the reporting quarter, the report on the banking sector financial stability indicators in the format agreed with the IMF staff.

29. Every 10 days, the NBU will continue to provide the IMF with the operational monetary survey of the NBU, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector.

30. The NBU will provide to the IMF, on a monthly basis, the net domestic assets data based on the monthly balance sheets within three weeks following the end of the month.

31. The NBU will continue to provide to the IMF the daily operational balance sheets of the NBU and commercial banks on a daily basis according to standard reporting forms, including detailed information on loans of the banking sector provided to the general government, with detailed breakdown of this information by indebtedness of the central (state) government and local budgets, including in national and foreign currency, by loan and by security, as well as the information on the balances of the funds of the Government held at the NBU, in particular, the balances of the Single Treasury Account denominated in the national currency (account 3240 A) and the funds of the State Treasury denominated in foreign currency (account 3513 A).

32. The NBU will provide to the IMF, on a monthly basis, projections for external payments falling due in the next twelve months. The data on actual settlement of external obligations, reflecting separately principal and interest payments as well as actual outturns for both the public and private sectors, shall be provided on a quarterly basis, within 80 days following the end of the quarter.

33. The NBU will provide to the IMF, on a quarterly basis, the stock of short- and long-term external debt (including arrears) for both public and private sectors.

34. The NBU will provide to the IMF on a daily basis aggregated data on main currency flows, including government foreign receipts and payments by currencies as well as currency breakdown of interbank market operations. The NBU will continue to provide daily information on exchange market transactions including the exchange rate.

35. The NBU will provide to the IMF reports N 381.25; 381.26 with information on reserve requirements.

36. The NBU will provide the IMF, on a two weekly basis, with daily data on the total financing (including refinancing) issued by the NBU to commercial banks, broken down by types of instrument, maturity (average weighted), interest rate as well as transactions to absorb liquidity from the banking system.

37. The NBU will provide the IMF on a two weekly basis, in an agreed format, data for the entire banking sector as well as on a bank-by-bank basis for Group I and Group II banks on total assets and liabilities; risk weighted assets (for ratio H2 calculation); capital adequacy ratios for normative and regulatory capital (Tier I and Tier II); deposits (maturity, currency, and type of depositor); loans (local currency, foreign exchange, provided to corporates and households, broken down by I, II, III, IV and V category); provisions for all loans (classified by types of loans); foreign exchange net open position; banks portfolio of government (domestic government bonds) and other debt securities; mandatory reserve requirement and assets held at the NBU.

38. The NBU will once a month inform the IMF any regulatory and supervisory measures against banks violating the NBU regulations on capital adequacy, liquidity ration, large exposures, and connected lending, as well as about decisions on declaring a bank as problem or insolvent.

39. The NBU will continue to provide on a monthly basis, no later than 25 days after the end of the month, banking system monitoring indicators in an agreed format. This includes inter alia data on nonperforming loans (III, IV and V category).

40. The NBU will continue to provide detailed quarterly balance of payments data in electronic format within 80 days after the end of the quarter.

41. The NBU will provide data on credit to nongovernment units that are guaranteed by the NBU on a monthly basis no later than 25 days after the end of the month.

42. The NBU will inform IMF staff if the Treasury does not pay interest or principal on domestic government bonds due to the NBU, deposit money banks, or nonbank entities and individuals. In such case, the NBU will provide information on outstanding interest and principal payments.

43. The NBU will inform IMF staff of any changes to reserve requirements for deposit money banks.

44. The NBU will communicate (electronically) to the IMF staff any changes in the accounting and valuation principles applicable to the balance-sheet data and will notify the staff before introducing any changes to the Charts of Accounts and reporting forms of both the NBU and the commercial banks.

45. The NBU Internal Audit Department will continue to provide an assurance report to the Fund, no later than six weeks after each test date, confirming that: (i) the monetary data are in accordance with program definitions and have been verified and reconciled to accounting records; and (ii) that there have been no changes to the chart of accounts or valuation methods that would impact the data reporting.

46. The NBU will continue to provide the Fund with a copy of the annual management letter from the external auditor within six weeks of completion of each audit. As required under the Fund's safeguard policy, this will remain in effect for the duration of the arrangement and for as long as credit remains outstanding.

B. Ministry of Finance

47. The Ministry of Finance will provide the IMF with the monthly consolidated balances (end-month) of other non-general government entities, including SOEs, holding accounts at the Treasury no later than 25 days after the end of the month.

48. The Treasury will continue to provide to the IMF reports on: daily operational budget execution indicators, daily inflow of borrowed funds (by currency of issuance) to the state budget and expenditures related to debt service (interest payments and principals), weekly balances of Treasury cash flow (outturn and forecast) , including data on government foreign exchange deposits, in a format agreed with IMF staff ,10-day basis data on revenue of the state, local government, and consolidated budgets, monthly data on funds, deposited with the Single Treasury Account, on the registration accounts of the entities which are not included to the state sector, information on the stock of public entities in account #3712 within the Single Treasury Account, on inflow to the State

budget from placing Treasury or any other liabilities to households in foreign and domestic currency and their redemption.

49. The Treasury will continue to provide to the IMF in electronic form monthly and quarterly treasury reports, no later than 25 and 35 days after the end of the period respectively. The Treasury will continue to provide to the IMF in electronic form the final fiscal accounts at the end of each fiscal year, no later than March of the following year. Inter alia, these reports will provide expenditure data by programs and key spending units, as well as based on standard functional and economic classifications. In addition, quarterly reports will contain standard information on budget expenses to cover called government guarantees.

50. The Ministry of Finance will report monthly data on the public wage bill in line with the template agreed with the IMF staff. It will also provide monthly reports on the borrowing (disbursements, interests and amortization) of UrkAvtoDor in line with the format agreed with IMF staff. The Ministry of Finance will report to the IMF on a monthly basis, no later than 15 days after the end of the month, the cash deficit of the general government, with details on budget execution data for privatization receipts of the state and local governments; disbursements of external credits (including budget support and project loans for on-lending) to the consolidated budget and amortization of external debt by the consolidated budget; net domestic borrowing of the general government, including net t-bill issuance, issuance of other government debt instruments, and change in government deposits. The Ministry of Finance will report to the IMF on a monthly basis information on municipal borrowing and amortization of debt in format agreed with IMF staff.

51. The Ministry of Finance will report to the IMF on a monthly basis, no later than 15 days after the end of the month, the cash deficit of the general government, with details on budget execution data for privatization receipts of the state and local governments; disbursements of external credits (including budget support and project loans for on-lending) to the consolidated budget and amortization of external debt by the consolidated budget; net domestic borrowing of the general government, including net t-bill issuance, issuance of other government debt instruments, and change in government deposits.

52. The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no more than 25 days after the end of the month, including separate line items for wages, pensions, social benefits, energy, communal services, and all other arrears on goods and services. The Treasury will report monthly data on accounts payable for state and local budgets (economic and functional classification).

53. The Ministry of Finance will provide monthly information, no later than 25 days after the end of each month, on the amounts and terms of all external debt contracted or guaranteed by the central government.

54. The Ministry of Finance will provide to the IMF in electronic form on a monthly basis, no later than 25 days after the end of the month, (a) data on the outstanding stock of domestic and external debt of the state and local budgets (including general and special funds), (b) the standard files planned and actual external debt disbursement, amortization, and interest payments (including general and special funds), broken down in detail by creditor categories as agreed with Fund staff, and (c) the report on external debt amortization and interest payments by days and currencies. The Ministry of Finance will also report the accumulation of any budgetary arrears on external and domestic debt service.

55. The Ministry of Finance will provide to the IMF monthly debt (domestic and external) amortization schedules updated on a weekly basis.

56. The Ministry of Finance will provide data on external and domestic credit to key budgetary spending units as well as nongovernment units (including Naftogaz, State Mortgage Institution, Deposit Guarantee Fund and Agrarian Fund) that is guaranteed by the government (amount of sovereign guarantees extended by executive resolutions and actually effectuated; total amount of outstanding guarantees and list of their recipients) on a monthly basis no later than 25 days after the end of the month.

57. The Ministry of Finance will provide data on the approved budgets and quarterly operational data (daily for the Pension Fund only) on the revenue, expenditures, and arrears, and balance sheets of the Pension Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this Fund), Social Insurance Fund, Employment Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this Fund), Occupational Accident and Sickness Insurance Fund, and any other extra budgetary funds managed at the state level no later than 50 days after the end of each quarter (each month in case of the Pension Fund). Any within-year amendments to the budgets of these funds will be reported within a week after their approval. The Ministry of Finance will also report the annual financial statement including the final fiscal accounts of those funds at the end of each fiscal year, no later than April of the following year.

58. The Ministry of Finance will report semi-annual data on the number of employees of budgetary institutions financed from the central (state) and local budgets, starting from

January 2010. After any public sector wage increase, the Ministry of Finance will provide an estimate of its costs for the current and two subsequent fiscal years, for the state and local government budgets.

59. The Ministry of Finance will provide, no later than 15 days after the end of each month, monthly data on the budgetary costs associated with the recapitalization of banks and SOEs. This cost includes the upfront impact on the cash deficit of the general government of the recapitalization of banks and SOEs as well as the costs associated with the payment of interests.

60. The Ministry of Finance will provide monthly data on their expenditure plans (ROSPIS) for state budget.

61. The State Fiscal Service (SFS) and, where applicable, State Customs Service (SCS) will provide monthly data, no later than 25 days after the end of the month, on tax arrears, inclusive of deferred payments, interest and penalties outstanding, in the following format:

	Beginning Stock				Netting out during month	I. DEFERRALS DURING MONTH	Write-offs (arrears written off during month)	Collections of outstanding debt at beginning of month	New Arrears (tax liabilities becoming overdue during month)	Ending Stock
	Total	Principal	Interest	Penalties						
Tax arrears										

62. The SFS will continue to provide on a quarterly basis, no later than two months after the end of the quarter, a listing of all tax exemptions granted, specifying the beneficiary the exemption provided, the duration, and the estimated subsequent revenue loss for the current fiscal year.

63. The SFS will continue to provide monthly information, no later than 25 days after the end of the month, on VAT refunds in the following format: (i) beginning stock of refund requests; (ii) refund requests paid in cash; (iii) refunds netted out against obligations of the taxpayer; (iv) denied requests; (v) new refund requests; (vi) end-of-period stock of requests; and (vii) stock of VAT refund arrears according to the definition in paragraph 11 (unsettled VAT refund claims submitted to the SFS more than 74 days before the end-of-period.

64. The SFS will continue to provide monthly reports 1.P0 on actual tax revenue and 1.P6 on tax arrears, no later than 25 days after the end of each month.

65. After each amendment of the state budget, the Ministry of Finance will provide data on revenue plans (ROSPIS) for state and local budgets.

C. Ministry of Economy, Ministry of Energy and Coal Industry, Ministry of Housing and Municipal Economy of Ukraine, NURC and NERC

66. The Ministry of Economy will provide quarterly information on actual levels of communal service tariffs in all regions for major services (heating, water supply, sewage and rent) and their level of cost recovery. In addition, the Ministry of Economy, the Ministry of Housing and Municipal Economy of Ukraine, and the National Energy Regulatory Commission will provide the methodology underlying the tariff calculations for full cost recovery, including heating and gas.

67. For each month, no later than the 25th of the following month, the government (based on information by the Ministry of Energy and Coal Industry, the Ministry of Economy, SFS/SCS, MoF, NERC, and Naftogaz) will provide IMF staff with information in electronic form (in an agreed format defined as "Ukraine: The Financial Position of Gas Sector") on financial indicators in the gas and heating sectors, including prices and volumes of domestically produced (by production entity) and imported (by sources of imports) gas, sales, tariffs, arrears, payments to the budget, subsidies, and debt. On a monthly basis, Naftogaz will provide to IMF staff updated information on the Company's financial liabilities, with a schedule of loan-by-loan interest and principal payments.

68. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information "in electronic form (in an agreed format) on the cash flows and deficit of the company, as defined above. This report will break down the total cash outlays for gas imports from Gazprom by month in a separate table mutually agreed with IMF staff. This report is subjected to auditing by a reputable external auditor, first on a monthly and then on a quarterly basis, as set out in the MEFP.

69. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in electronic form in an agreed format on the domestic gas used by Naftogaz for sales to households, heating utilities, budget institutions, and industries, including gas produced by SC "Ukrgasvydobuvannya," SJSC "Chornomornaftogas," and OJSC "Ukrnafta".

70. For each quarter, no later than the 25th of the following month, the Ministry of Housing and Municipal Economy will provide IMF staff with information of the quantity of heating energy meters installed at a building-level measured also as a ratio to the applicable buildings.

71. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in electronic form on the amount of Naftogaz arrears to domestic suppliers including Naftogaz subsidiaries, Ukrtransgas, Ukrgas vydobuvannya, Ukrnafta, Chornomornaftogas 90 days after they are due.

72. The Ministry of Energy and Coal Industry (based on information by Naftogaz) will report on a weekly basis data on Naftogaz daily market purchases of foreign exchange.

D. State Statistics Service

73. The State Statistics Service and Naftogaz will provide to the IMF, on a monthly basis, no later than 45 days after the end of the month, data on prices, volumes, and payments (payments data provided by Naftogaz) for imported and exported oil and natural gas by country of origin and destination.

74. In case of any revisions of gross domestic products the State Statistics Service will provide to the IMF revised quarterly data on gross domestic product (nominal, real, deflator) and their components (economic activities, expenditure, income), no later than 10 days after any revisions have been made.