

**FOR
AGENDA**

EBS/00/177

Supplement 2

CONFIDENTIAL

September 5, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Ukraine—Misreporting of Information on the International Reserves of
the National Bank of Ukraine**

The attached supplement to the paper on misreporting of information on the international reserves of the National Bank of Ukraine (EBS/00/177, 8/23/00), has been prepared on the basis of additional information. A draft decision appears on pages 3 and 4.

Mr. Berengaut (ext. 38773) and Mr. Leckow (ext. 34799) are available to answer technical or factual questions relating to this paper prior to the Board discussion scheduled for Wednesday, September 6, 2000.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

UKRAINE

**Misreporting of Information
on the International Reserves of
the National Bank of Ukraine—Supplementary Information**

Prepared by European II and Legal Departments

(In consultation with other Departments)

Approved by John Odling-Smee and François Gianviti

September 5, 2000

1. This supplement provides additional information on recent developments and issues related to misreporting in Ukraine. It also sets out a proposed decision.
2. On August 25, the authorities made a voluntary repurchase of SDR 72.5 million of the two noncomplying purchases that Ukraine would not have been entitled to make, as discussed in EBS/00/177, had it not overstated the level of its net international reserves. These two noncomplying purchases, each amounting to SDR 36.27 million, were effected on December 29, 1997 and February 2, 1998.
3. On August 29, 2000, the authorities sent a letter to the Managing Director (copy attached), in which they note the voluntary repurchase and confirm that they will maintain the safeguards put in place in the context of the Extended Arrangement during the period of the arrangement and beyond, until such time as the Fund and Ukraine agree that they are no longer necessary. In addition, the authorities state that they will keep the proceeds of any purchases made under the EFF arrangement in Ukraine's SDR account held with the Fund.
4. The draft third stage audit of the foreign reserves of the National Bank of Ukraine, which covers the period January 31 to September 30 1998, has just been completed and the report will be placed on the Websites of the NBU and the Fund. The staff will provide the Board with a separate report on the implications of the third-stage PwC Report under Article VIII, Section 5 and the Guidelines.
5. As of August 30, Ukraine's usable gross international reserves stood at \$1.1 billion, close to the level at end-1999 and representing about 3 weeks of imports of goods and nonfactor services.
6. Attached is a proposed decision respecting Ukraine's breaches of obligation under Article VIII, Section 5. The proposed decision: (i) finds Ukraine to have breached its obligation under Article VIII, Section 5 to report accurate information to the Fund; (ii) notes

the voluntary repurchase of SDR 72.5 million made by Ukraine on August 25, 2000;¹ (iii) notes the statement set out in the Ukrainian authorities' letter that Ukraine will ensure that the reserve position of the NBU is audited on a quarterly basis by a reputable international accounting firm, that the reserves of the NBU will only be held in first-rank international banks, and that no operation will be undertaken that may impair the liquidity of such reserves; and (iv) notes the Managing Director's intention to make a complaint for a declaration of ineligibility of Ukraine to use the Fund's general resources in the event that the authorities, during the period of the EFF arrangement or such longer period as the Managing Director deems appropriate, fails to adhere to the understandings described in (iii) above. As provided for in EBS/00/177, this decision would be published.

7. Section V of EBS/00/177 proposed that the Board, under the Guidelines on Misreporting, refrain from establishing a repurchase expectation respecting the two noncomplying purchases totaling SDR 72.5 million and, instead, grant a waiver for nonobservance. As the authorities have already made a voluntary repurchase of the entire amount of these two purchases, the remedy (i.e., a repurchase expectation or a waiver) specifically referred to in the Guidelines can no longer be applied. Thus, the Fund cannot establish a repurchase expectation with respect to an amount that has already been repurchased. Accordingly, there is no need for the Fund to grant a waiver as the purpose of the waiver would be to allow the member to keep the proceeds of the noncomplying purchase.² It is, however, proposed that the summing up of the Chairman on the discussion of Ukraine's misreporting include an express finding by the Board that Ukraine made two noncomplying purchases in a total amount of SDR 72.5 million. This summing up would be published.

¹ Section V of EBS/00/177 contemplated that the proposed decision respecting Article VIII, Section 5 would note the Managing Director's intention to make a complaint for a declaration of ineligibility if Ukraine did not make a voluntary repurchase of SDR 72.5 million within 90 days of the date of their letter. As this repurchase has already been made, it is now proposed that the decision simply note the voluntary repurchase made by the Ukrainian authorities.

² While EBS/00/177 contemplated that the Fund would grant a waiver under the Guidelines, it also provided that Ukraine would, within 90 days of the date of their letter, make a voluntary repurchase of the entire amount of the noncomplying purchases.

Proposed Decision

The following draft decision is proposed for adoption by the Executive Board.

Breach of Obligation under Article VIII, Section 5

The Fund has reviewed the report set forth in EBS/00/177 (the “report”) on the misreporting by Ukraine of information to the Fund under the stand-by arrangements approved for Ukraine on May 10, 1996 (EBS/96/67, supp. 2) and August 25, 1997 (EBS/97/144, supp. 1) and adopts the following decision:

(a) the Fund finds that, with respect to each instance of misreporting specified in paragraph 13 of the report, Ukraine breached its obligation under Article VIII, Section 5 to report accurate information to the Fund;

(b) the Fund notes (i) the voluntary repurchase of SDR 72.5 million made by Ukraine on August 25, 2000, and (ii) the statement set out in the letter of the Prime Minister of Ukraine and the Governor of the National Bank of Ukraine received on August 29, 2000, that Ukraine will ensure that the reserve position of the National Bank of Ukraine is audited on a quarterly basis by a reputable international accounting firm, the reserves of the National Bank of Ukraine will only be held in first-rank international banks, and that no operation will be undertaken that may impair the liquidity of such reserves; and

(c) the Fund notes the Managing Director’s intention to make a complaint for a declaration of ineligibility of Ukraine to use the Fund’s general resources under

Article XXVI, Section 2 (a) of the Fund's Articles for the breaches of obligation specified in paragraph (a) above in the event that Ukraine, during the period of the extended arrangement approved for Ukraine on September 4, 1998 (EBS/98/144, supp. 3) or such longer period as the Managing Director deems appropriate, fails to adhere to the understandings set out in paragraph (b)(ii) above.

Mr. Horst Köhler
The Managing Director
International Monetary Fund
Washington DC 20431

Dear Mr. Köhler,

We understand that according to the findings of the IMF staff Ukraine on several occasions in the context of the 1996 and 1997 stand-by arrangements reported information to the Fund that overstated the level of its international reserves, which the staff concluded, resulted in a breach of Ukraine's obligations under the Articles of Agreement to provide accurate information to the Fund and allowed Ukraine to make in December 1997 and February 1998 two purchases of SDR 36.27 million each that it would not have been entitled to make otherwise.

With a view to putting this matter firmly in the past we are now voluntarily effecting the early repurchase of the two purchases referred to above. The early repurchase of SDR 72.54 million took place on August 25.

In view of our intention to further develop our cooperation with the IMF, which we have always valued and which has contributed to the implementation of economic reforms in Ukraine, we commit to ensuring the accuracy, integrity and correct definitions of the information that Ukraine provides to the Fund. In the context of the Extended Arrangement approved in September 1998, we have taken a number of steps in this direction and have strengthened safeguards regarding the use of balance of payments support from the Fund. In particular, we have instituted quarterly audits of the reserve position of the NBU by a reputable international audit firm, strengthened the reserve management functions at the NBU, initiated the practice of holding the NBU's reserves in first-rank international banks, and refrained from undertaking any operation that may impair the liquidity of reserves.

We are committed to keeping these measures in place during the period of the EFF and beyond, until such time as the Fund and Ukraine agree that they are no longer necessary. In addition, we intend to keep the proceeds of any purchases made under the EFF arrangement in Ukraine's SDR account held with the Fund and to use those proceeds as agreed separately.

We authorize the Fund to make this letter public.

Yours sincerely,

/s/

Victor Yushchenko
Prime Minister of Ukraine

/s/

Volodymyr Stelmakh
Governor of the National Bank of Ukraine

