



# SHADOW REPORT

## JSC "UKRAINIAN RAILWAYS"

### 2018



## About us:

The project "Railway Without Corruption" was launched in partnership with Transparency International as an initiative aimed at coverage the acute problem of corruption, procurement efficiency and management decisions of the largest state-owned company in Ukraine - JSC "Ukrainian Railways".

The main purpose of our work is to ensure publicity in the field of rail transport, to expose corrupt schemes to steal and inappropriate use of state funds by JSC "Ukrainian Railways", productive cooperation with the leadership of Ukrainian Railways, aimed at elaboration a strategy for enterprise development.

The project participants are experts in the field of railway transport, public procurement and opposition corruption.

## Our partners:



**CONTENT:**

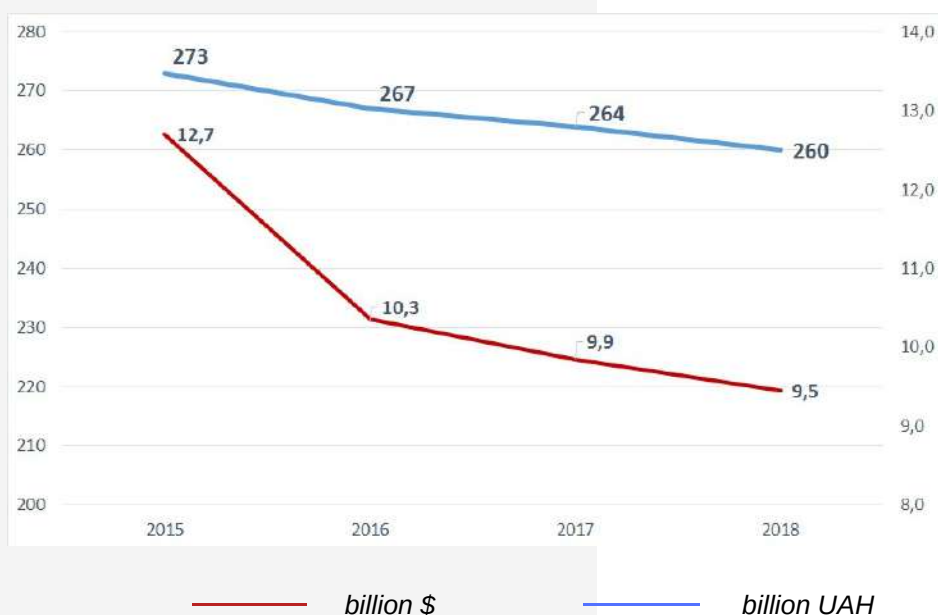
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# ASSETS



The aggregate value of the assets of the company in accordance with the financial statements for 2018 is 260 billion UAH. (\$ 9.3 billion). In 2015, this figure amounted to 273 billion UAH. or \$ 12.7 billion at the average annual exchange rate. In sum for the period from 2015-2018, the joint-stock company lost 5% of the in the national currency and 26% of the value in US dollars.

### Value of Assets Ukrzaliznytsia, billion UAH / \$



### Information: Consolidated Reporting of Ukrainian Railways (UR)

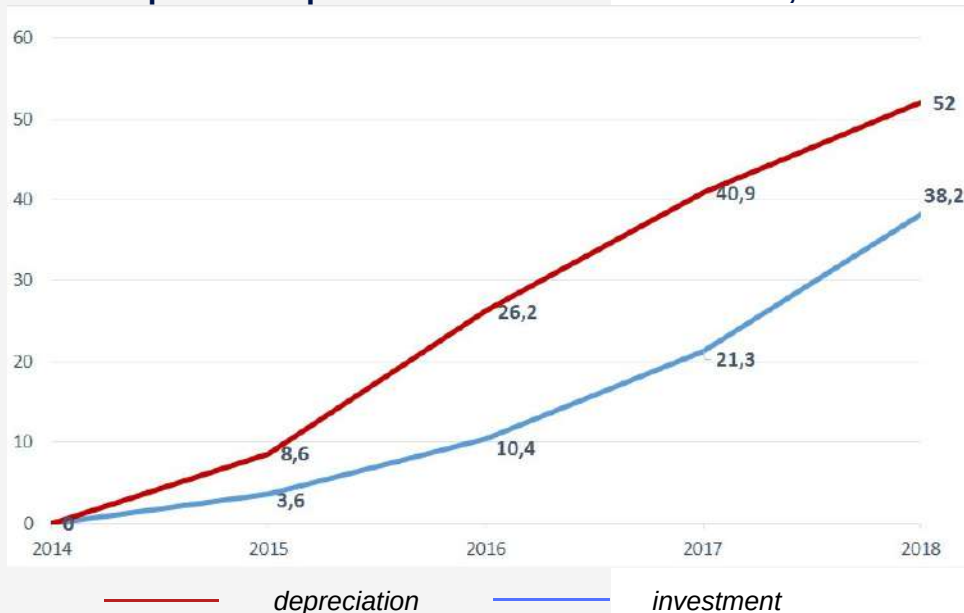
The initial value of assets held in 2017 according to the financial statements of the company amounted to 645 billion UAH. The total impairment of the company's assets is 60%.

This is due to the significant lag of the company's capital investment rates for the renewal of fixed assets, as compared to their depreciation.

During 2016-2018, depreciated assets with a residual value of UAH 23.2 billion were withdrawn from the funds of the Ukrainian Railways. (\$ 830 million). Assets valued at UAH 15.6 billion. have full depreciation, but still in use.

The pace of depreciation and impairment of Ukrainian Railways assets significantly exceed the rate of capital investment. Thus, for 2015-2018, the volume of capital investments amounted to UAH 38.2 billion, while the level of asset wear is 52 billion UAH.

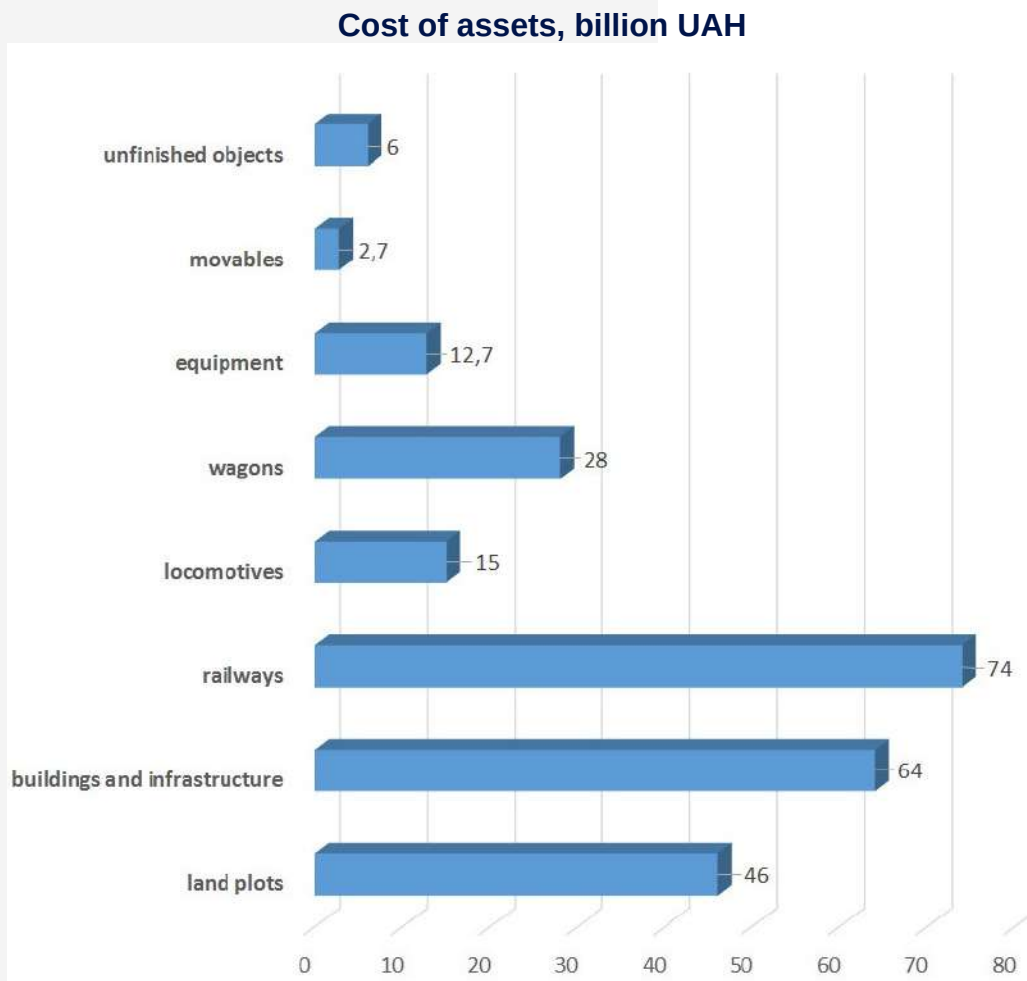
### The pace of depreciation and investment rates, billion UAH



### Information: Consolidated Reporting of UR

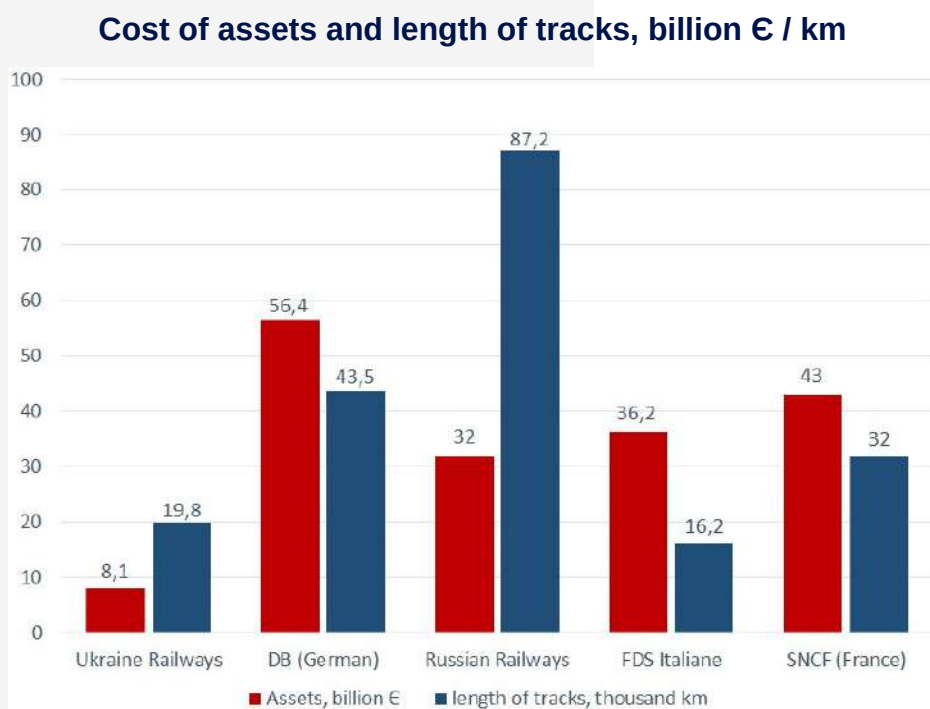
In the case of the preservation of the negative dynamics, "Ukrainian Railway" will gradually lose its assets, and in the long term, 10-15 years, the probable occurrence of the critical depreciation of the main productive assets. As a result, JSC "Ukrainian Railways" will lose the opportunity to fully satisfy the requirement of the economy and cargo transit.

### Company Assets Structure:



Information: Consolidated Reporting of Ukrainian Railways (UR)

### Assets of some companies in Europe:

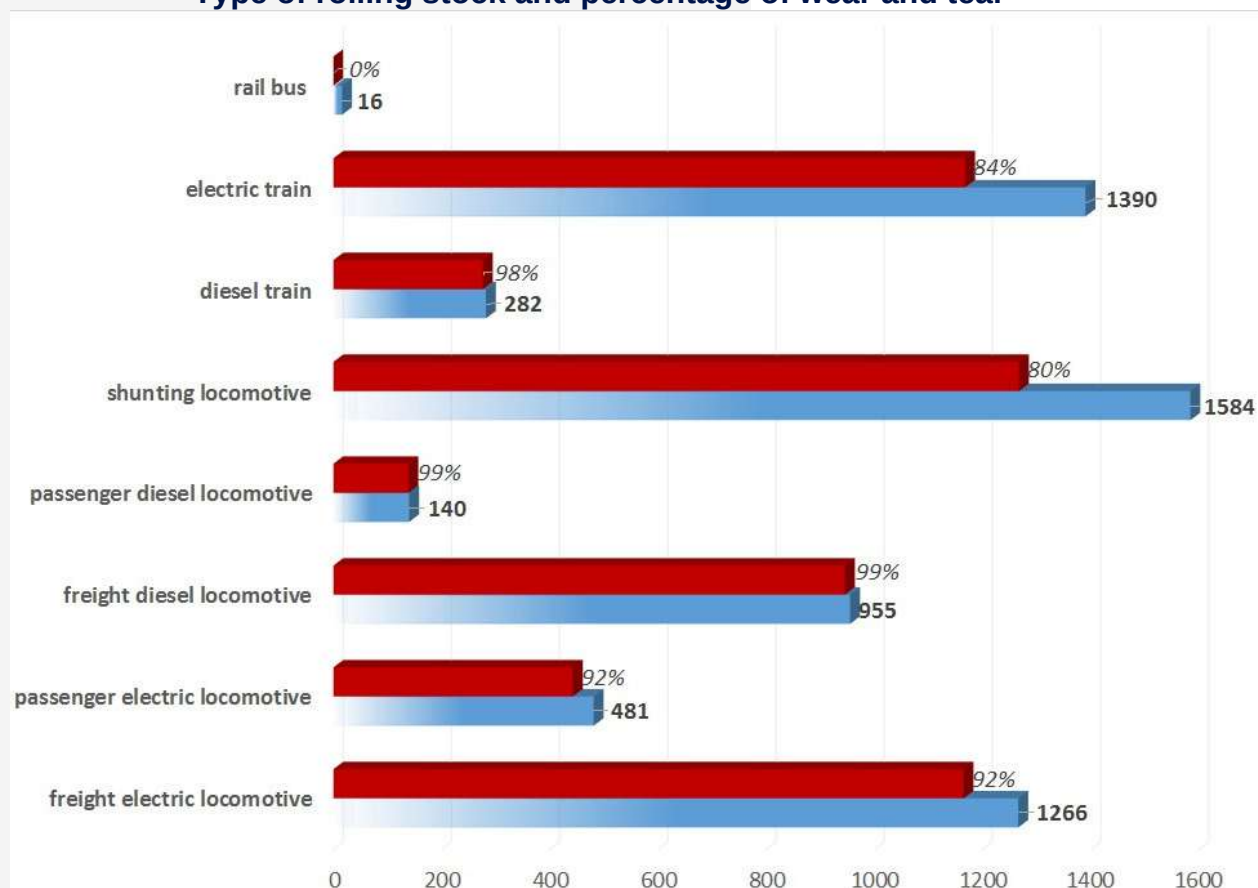


## LOCOMOTIVES

The value of assets in the form of traction rolling stock is 5,8% of the book value of all assets of the company. Average residual value of one locomotive - 3.4 mln. UAH (121 thousand dollars), which is about 4-5% of the market value of the new locomotive.

The low level of locomotive cost is explained that about 95% of the available locomotives of the "Ukrainian Railway" is operated with the exceeding of the standard service life, are technologically and morally obsolete. The use of available locomotives negatively affects the technical and economic indicators of the railway. These include factors such as average train speed, idle times locomotives on scheduled and unscheduled repairs, low energy efficiency, and increased levels of hazardous and harmful factors.

**Type of rolling stock and percentage of wear and tear**



**Information: Ukrainian Railways (UR)**

In general, in the park "Ukrainian Railways" there are 4400 locomotives and 1680 trains.

The wear and tear of a locomotive park is:

- main electric locomotives - 92%;
- main diesel locomotives - 99%;
- shunting locomotives - more than 80%;
- diesel trains - 98%;
- electric trains - 84%.

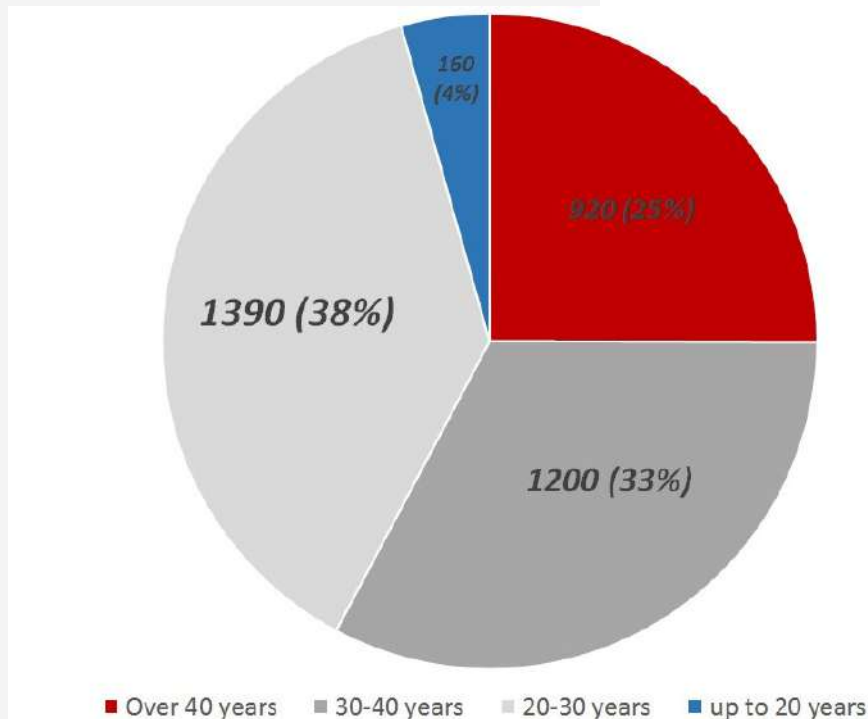
Most of locomotives and multiple traction units have an average age of over 30 years. 26% of locomotives have an age of over 40 years and are exploited with the exceeding of the standard operating life (maximum term of 25-30 years).

During 2018, less than 130 major overhauls of locomotives were performed, which is less than 3% of the total needs. Major repair of locomotives is carried out without modernization of traction equipment. The replacement of non-usable equipment is mostly carried out by restored equipment, which has a low level of efficiency and reliability.

Locomotives of JSC "Ukrzaliznytsya" use morally and physically obsolete knots and mechanisms, developed in the 70-80s of the last century. As a result, an increase in operating costs for fuel and lubricants, limitation of speed and maximum train weight, and considerable expenses for maintenance of traction equipment.

There are series of locomotives in the operation park of Ukrzaliznitsa which technological solutions are outdated for 40-50 years. In particular, the latest electric locomotive of the series ВЛ-8 was built in 1967. However, such locomotives are still widely used on the territory of our country (more than 400 units in the park of Ukrzaliznytsia).

**Age of Locomotives**



**Information: Ukrainian Railways (UR)**

Therefore, only 4.5% of the company's locomotives in operation are in optimal age limits. 95.5% of locomotives require a major upgrade or replacement within the next 5-10 years.

The total need for capital investment in the traction sector is \$ 7-10 billion. An additional company needs investments in the amount of up to 5 billion US dollars for the restoration of regional and suburban passenger transport (renewal of diesel and electric trains). In turn, the complete transfer of these costs to the cost of services makes rail transport uncompetitive compared to other types of traffic.

The need for large-scale capital investment in short periods of time leads to an overload of the consumable portion of the company's balance sheet and may lead to deterioration in financial stability and even to technical defaults. At the same time, failure to take measures to upgrade the locomotive fleet of the "Ukrainian Railway" may lead to a large-scale collapse and the inability of the railways to carry out the necessary volumes of transportation.

Simultaneously with the outdated fleet of locomotives, Ukrzaliznytsya has a significant technological lag behind repair bases that are not specialized in servicing modern locomotives. As an example, the experience of the operation of DC-3 electric locomotives (years of issue 2003-2008), most of which are in faulty condition due to do with substandard servicing.

Available repair capacities can't provide timely repairs and modernization of locomotives. Thus, major repairs of diesel locomotives are being carried out at present by the only enterprise - PJSC "Dnipropetrovsk Diesel Locomotive Works", the output of repair of which is about 50 units per year. Repair of DC and AC electric locomotives is carried out at PJSC "Lviv Locomotive Repair Plant" and PJSC "Zaporozhye Electric Locomotive Repair Plant" (repair output up to 100 units per year).

Locomotive repair plants show low levels of volume and quality of capital repairs. The high level of repairs un-

der guarantee after overhauls, the lack of innovative technological solutions, and the replacement of major nodes with modern analogues are the norm for today. Locomotive repair plants mostly support working condition, not modernize. Thus, "Ukrainian Railways" is not able to provide complete modernization of locomotives without updating the main production assets and technologies of repairing locomotives, using modern technological solutions.

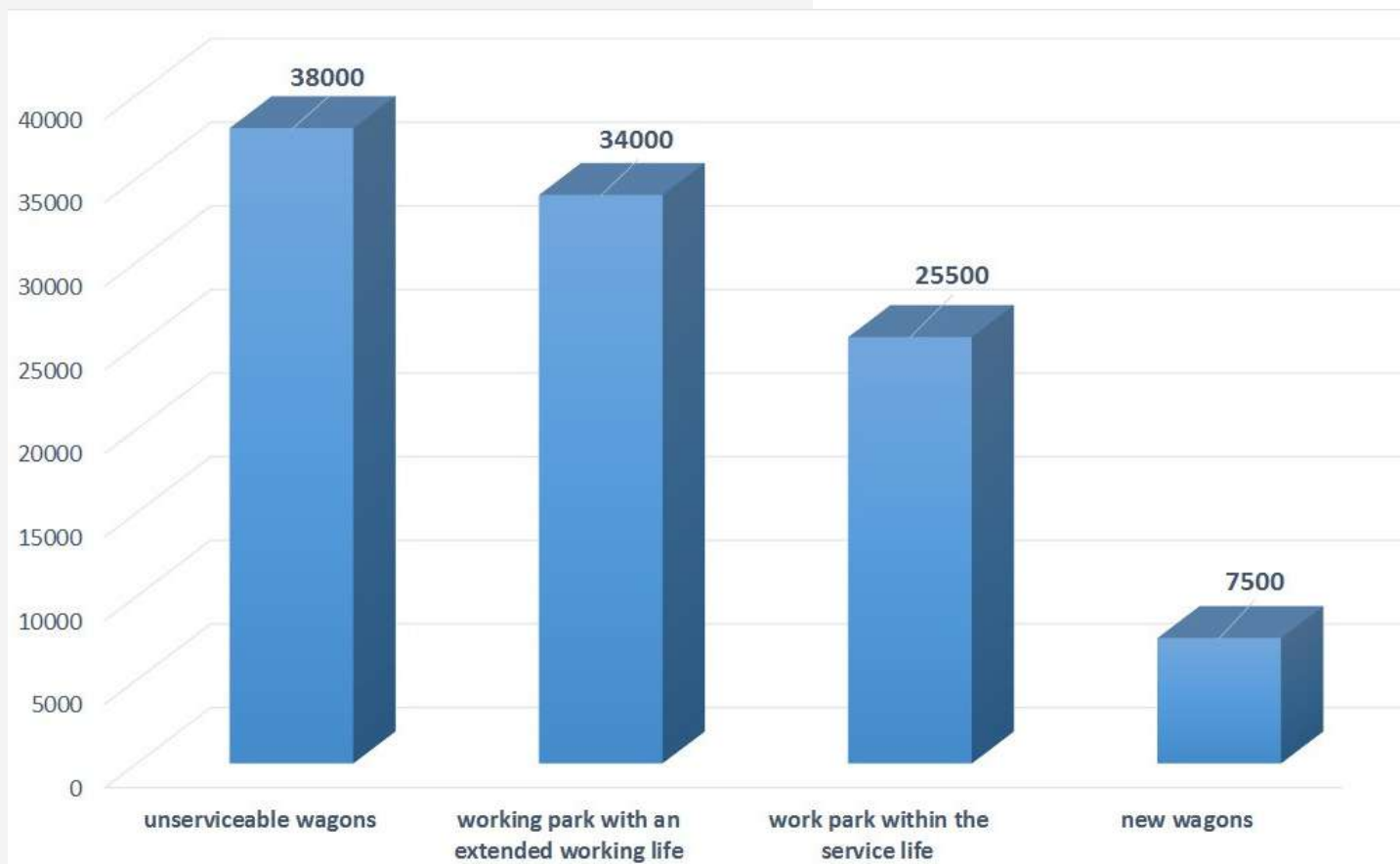
The conclusion of a contract with General Electric for the supply of locomotives demonstrates positive dynamics, but the planned production volumes do not allow us to talk about the prospect of tackling the problem of traction in 10-15 years. Along with this remains unresolved issue of shunting locomotives, diesel and electric trains. The issue of upgrading the fleet of electric locomotives is at the stage of study.

The company is in urgent need of a well-balanced strategy for the restoring of a locomotive park with an implementation period of up to 15 years.

## FREIGHT TRANSPORTATION

The total number of freight cars owned by JSC "Ukrzaliznytsya" is 105 thousand units. The average age of a freight wagon is 23 years. High-sided open wagons (72% with the exceeding of the standard operating life) and grain car (88% with the exceeding of the standard operating life) have the highest percentage of wear and tear.

### Freight Car Fleet

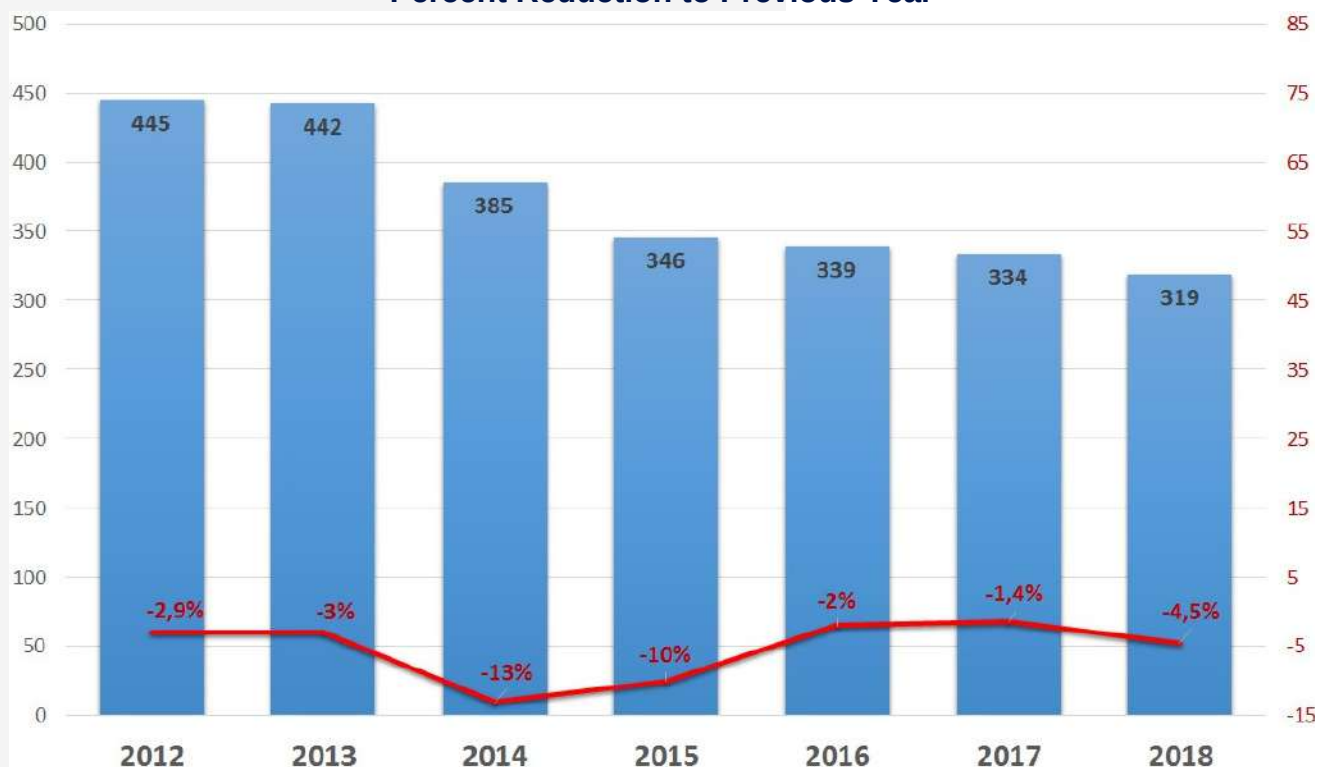


Information: Ukrainian Railways (UR)

In the past 3 years, the railway has begun to implement measures to upgrade the fleet of freight cars. Since 2016, "Ukrainian Railways" has replenished a fleet of 7.5 thousand units of new cars. Nevertheless, the negative factors are the low timeliness efficiency of cargo transportation, which leads to inefficient use of the existing park. As an example, most countries of the world switched to calculating the time of delivery of goods by rail for an exact hour and minute, the time of delivery of cargo on Ukrzaliznytsia is still measured in a days. The insufficient number of carriages for servicing consignors has survived in 2018 and forms the negative reputation of the "Ukrainian Railways" in the issue of the quality of service provision. So, in 2018, compared to 2017, the time of the freight wagon turnover increased by 5%. This negatively affects the efficiency of using rolling stock and its performance.

The average freight wagon turnover (time for one cargo transportation order) in 2018 is 10.5 days. In 2017, this figure was 9.26 days (11.2% less). In 2011, this indicator was 5.9 days. Thus, for 7 years, the turnover rate of the freight car on the "Ukrainian railway" has decreased by 75%. This leads to an increase in freight wagon deficiencies to meet the transportation needs and inefficiencies use of the freight wagon park. These factors negatively affect the share of "Ukrzaliznytsia" in the total number of goods transported by the country. During the last 6 years, the stable negative dynamics of volumes of transportations has been maintained. In total, the number of transported goods by the railway decreased by 28%.

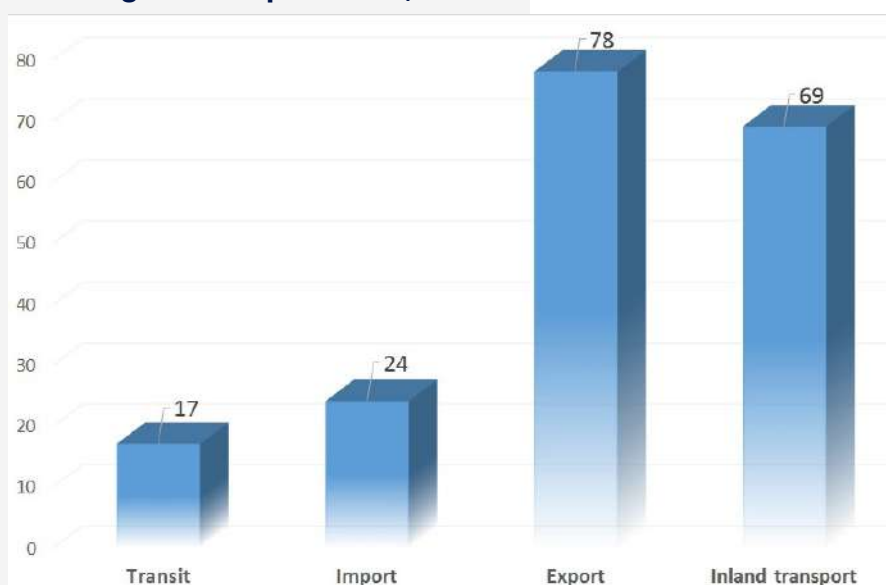
**Dynamics of Volumes of Transportations, million tons /  
Percent Reduction to Previous Year**



#### Information: Center for Transport Strategies

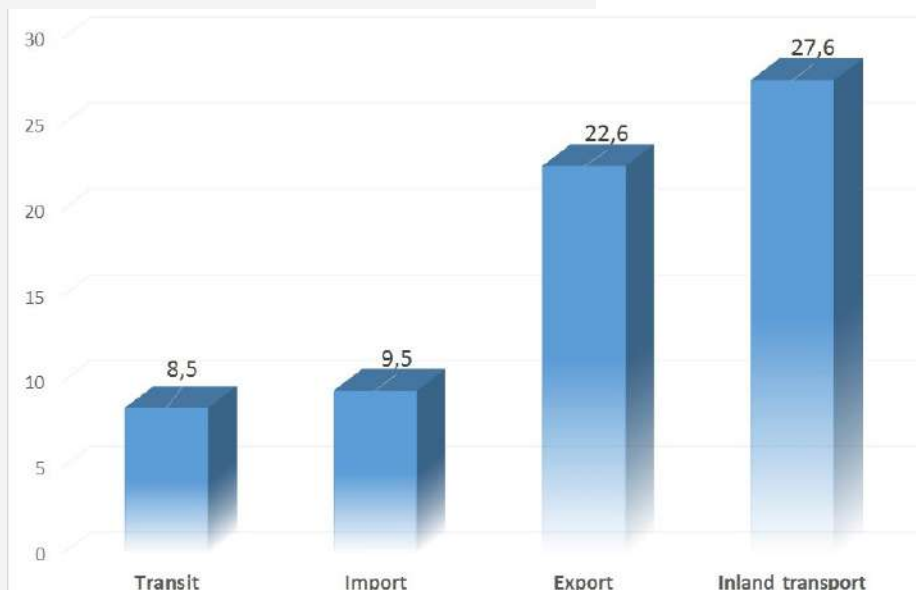
On average, for one freight wagon of an operating fleet falls workload of 1.5 million ton kilometers per year. The structure of freight transportation:

**Freight Transportation, million ton kilometers**



Income from freight transportation:

**Income from the Carriage of Goods, billion UAH**



**Information: UR**

The average technical speed of freight trains is 43.3 km / h. In 2017 this indicator was 45.3 km / h. Thus, during the year, the speed of freight trains decreased by 4.4%.

## ACCESS TO FREIGHT SERVICES

In 2017, the railway board announced the introduction of an automatic distribution of freight cars, which made it impossible to have corruption risks while executing consignors' applications.

However, since mid-2018, this project has been curtailed. The official reason for the cessation of the automated allocation of freight cars was the drawbacks in software of the distribution system. Subsequently, the railway did not resume operation of the system and continues to carry out the allocation of freight cars in "manual mode".

Under these circumstances, the priority of satisfying the needs of carriers depends on decisions of officials of Ukrzaliznytsia, which is a corruption-causing factor.

At the end of 2018, as an experiment, "Ukrainian Railways" introduced a partial distribution of cars at the auction through the electronic platform "ProZorro.Sale". Such a system allows transparent distribution of the existing fleet of cars. However, the existence of a shortage of freight rolling stock in the transportation market, the auction system of access to services and the additional costs for exceeding demand over the offer is not a predictable and objective criterion for determining the value of services and meeting the needs of consumers. One of the main drawbacks of cargo transportation is the lack of a transparent principle in the forecasting of tariff formation for cargo transportation in accordance with price-setting factors. That fact has negative consequences for the operation of the company and the economy as a whole. The process of increasing tariffs for services is not consistent and understandable. Instead of a gradual increase in line with price-setting factors, the approval of tariffs on Ukrainian Railways by the Cabinet of Ministers has a non-system character, and increases are carried out at once by 10-15% every time, as a result it has stressful nature effect to the country's economy.

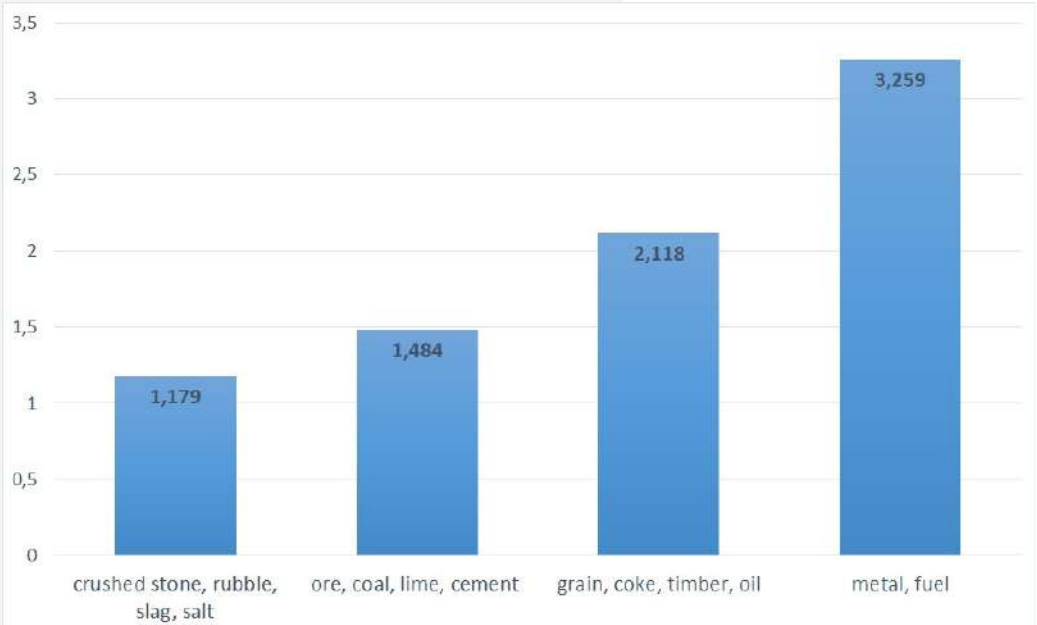
The principle of the projected tariff calculation will enable consignors to plan their business activities rapidly. This will contribute to the timely provision of Ukrzaliznytsia's production needs at the expense of compliance with the current tariff with reasonable expenses.

At the same time, the possibility of increasing the rail freight costs is limited competition from other types of transportation.

Thus, the cost of rail transportation remains an average of 2.2 times lower than the cost of road transportation (0.4 UAH / tkm compared with 0.9 UAH / tkm). In 2019 the planned rail transportation costs increase to 0.45 UAH / tkm. However, the low speed of rail transportation and high percentage of cargo losses significantly restrict the competitiveness of the railway transport in the freight transport market.

In addition, the tariff for rail transportation depends on the type of cargo. In general, the cost of rail services can vary up to 2.8 times depending on the type of cargo, using the same type of wagon and transporting at the same distance.

Rate of Fare, Depending on the Type of Cargo



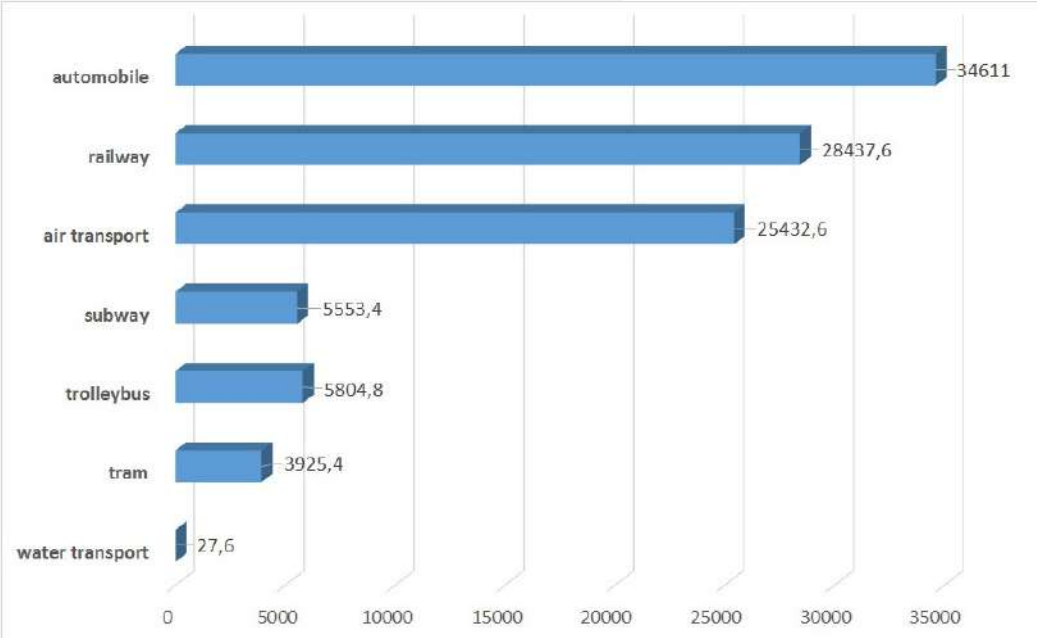
Information: UIC

Such a system of differentiation of the fare costs for using one type of cars is not used on most modern railways of the world and has no economic rationale. That there is such a problems mace a potential risk to hold its position by the Ukrainian Railway in the freight transport market, requiring systemic and urgent solutions.

PASSENGER TRANSPORTATION

In passenger transportation, there is a steady dynamic of reduction of the share of rail transport in comparison with other modes of transport. By the period from 2014 to 2018, according to the State Statistics Service, the share of rail passenger traffic decreased from 35.6% to 27.4% from the total number. With the improvement of road infrastructure and the development of air travel, the share of rail transport in the passenger transport market will continue to decrease. The total volume of passenger transportation by the railway transport is 28,438 million passenger kilometers.

The Volume of Transportation in Passenger/kilometers



Along with this, the railway has increased the sale of tickets from 53.7 million to 55.9 million sold tickets per year. This indicates a general dynamic of the increase of population mobility in Ukraine.

During the year, 11 new routes were introduced, including the EU countries. This indicates an improvement in the efficiency of international rail transport. At the same time, there is a high probability of domestic traffic related to the wear and tear of passenger car fleets and low service.

The amount of revenues from passenger transportation in 2018 is UAH 8.7 bln. At the same time, the suburban trains are the least profitable - UAH 690 mln. in a year.

During 2018, Ukrainian Railways signed contracts for the construction of 54 new passenger cars, overhauling 118 passenger cars. The overall indicator for the renewal of passenger cars is 3.9%.

About 90% of the cars are not equipped with vacuum toilet systems. More than 60% of passenger cars are not equipped with air conditioning systems.

The average speed of trains in the passenger traffic of long distance is 60-80 km / h, and in the suburban traffic - less than 60 km / h, which is a lower indicator for passenger transport in most cases.

No air conditioning systems and outdated heating system cause in uncomfortable conditions for the transportation of passengers.

At the same time, the renewal and modernization of the fleet of cars takes place at a slow pace (50-100 wagons a year or about 3% of the need), and inferior to the rates of aging of the existing inventory park of Ukrzaliznytsia.

The aging and unsatisfactory technical condition of the passenger park leads to a restriction of speed, a decrease in the quality of provided services and comfort, and adversely affects at the safety of transportation.

## INFRASTRUCTURE

The cost of fixed assets of the company in the form of railway tracks is 28.5% of the value of all assets and it is the most important component. The average book value of 1 km of roads is 1,86 mln. UAH. (\$ 66 thousand).

### **Length of runways 39 835km:**

- main roads - 26 762 km;
- station and special - 11 139 km;
- driveways - 1,934km.

Of these - 6,938km of track equipped by the wooden sleepers.

Not operational (closed) tracks - 1 693 km.

### **Speed:**

- speed tracks (over 120 km / h) - 2880,5 km or 7.2%;
- speeds less than 120 km / h - 36 954,5 km or 92,8%;
- maximum speed - 160 km / h.

### **Operating condition**

- Need capital repair - 8 400 km of tracks (wear of 21%);
- in 2018, overhaul of 555 km of roads (6.5% of the need) was completed;

During 2017-2018, a few infrastructure facilities were implemented, in particular the construction of the Beskid Tunnel, the railway connection between Kyiv and Boryspil International Airport was completed, the modernization of the Komish-Zorya-Volnovaha line was carried out, carried out modernization of auto-blocking and signaling systems. This indicates improvements in infrastructure services in certain areas.

However, the overall state of the infrastructure requires significant upgrades and updates. The deterioration of more than 20% of the tracks and their subsequent operation poses a potential threat to the provision of high quality and safe freight and passenger transportation services. The presence of tracks operated in violation of the terms of repair leads to the use of speed restrictions and lower average speed of transportation of cargo and passengers.

The company's high-speed movement remains poorly developed and represents service of separate areas at a maximum speed of 160 km / h. However, such a movement is possible only on 2.9 thousand kilometers of tracks. Therefore, most of the speed connection has a limited maximum speed of 120 km / h, which is significantly inferior to those of other European countries.

Implementation of high-speed traffic over 160 km / h on Ukrzaliznytsia is not realized.

A significant drawback in the potential development of infrastructure is modernization by using of the outdated 25-meter R-65 rails, which have increased wear and reduced durability compared to modern UIC-60 rails and their counterparts. The use of P-65 rails is ineffective for the construction of tracks with a maximum speed of over 120 km / h.

# INTERNAL RISK MANAGEMENT

JSC "Ukrainian Railways" has a wide range of internal risks, which consist of a high level of corruption abuses, opacity of the company's personnel system and high political dependence.

Over the past two years, more than 50 criminal proceedings have been opened on corruption offenses at the Ukrainian Railways. The general level of losses of the company according to open criminal cases is about 3 billion UAH. (\$ 107 million). At least to 20 top managers of the company, some of which continue to remain in service, are incriminated organization and execution of larcenies in a particularly large scale.

During 2018, several appointments to responsible positions of persons with high reputational risks took place in the "Ukrainian Railway". Personnel appointments are taking place without using of transparent tools for evaluation and selection of candidates.

The company has no effective tools for preventing and combating corruption and causing damage to the company. The potential reserve for increasing the efficiency of using revenues through the elimination of corruption-related risks is 5-10 billion UAH. per year (up to \$ 350 million).

In accordance with the legislation on prevention of corruption by the Ukrainian Railways from 2016, an anti-corruption program has been approved, but its implementation has not been realized, and the program itself remains a formal act.

According to the regulations of the National Agency for the Prevention of Corruption during the period of the anti-corruption program of JSC "Ukrzaliznytsya", no assessment was made of corruption risks and the development of measures to prevent corruption. The Agency drafted 36 administrative protocols regarding the members of the Board of JSC "Ukrainian Railways" for violating the legislation on the prevention of corruption and sent orders to the chairman of the board on the need to eliminate the violations found.

According to the response of the National Agency for the Prevention of Corruption, the chairman of the Board of Ukrzaliznytsya JSC has not complied with the agency's order and it was not report in accordance with the established procedure about elimination the revealed violations.

The internal risk management functions of the company are assigned to the Department of Internal Audit and Control and the Department of Economic and Information Security.

At the same time, the reputation of these units does not allow talking about the effectiveness of countering internal risks. So, over the past two years, the head of the Internal Audit Department has been detained while receiving a bribe for the approval of personnel appointment of \$ 300 thousand. The leadership of the Department of Security for 2 years changed 3 times. These appointments have high reputational risks. The current head of the Department of Economic and Information Security is a former employee of the security forces, a person for whom investigatory actions were carried out in the years 2015-2016 in connection with the extortion and taking of bribes.



The process of selecting and appointing heads of these departments is opaque and closed, which calls into question the continued effectiveness of these institutions.

Despite the adoption in March 2016 of the decision to create an independent body to counter the internal risks - "compliance-office" in the structure of the company, the implementation of this decision did not take place. In fact, the announcement of the competition for the "compliance-office" director took place only in August 2017, but within 1.5 years the relevant person was not selected, the establishment of an independent body has not been started.

At the same time, the announcement of the competition was not transparent, without specifying the composition of the competition commission for the selection of candidates, the provisions on the body to which the candidates were elected (with a clear indication of duties and powers, the procedure for formation, the structure of the body, etc.).

It is worth noting that the election of members of the "compliance-office" on a non-transparent basis or through decision-making by company employees who will in fact be controlled by the body to which the candidates are elected creates the preconditions for biased decisions. Improper selection and dependence of the body to which the functions will be assigned on prevention of corruption and protection of the economic interests of the company, which in fact does not correspond to the purposes of creating the specified office and is inadmissible.

## CORPORATE DISCIPLINE

The company does not have an effective Code of Service (Corporate) Ethics and does not have a working system of disciplinary responsibility of officials for violating the interests of the company, adopting corrupt and illegal decisions and other actions committed contrary to the interests of the company.

As a result, there is no effective mechanism for bringing disciplinary responsibility for actions that contradict the interests of the company and frequent cases of dismissals of officials who are appealed in court. On some cases a decision has been made to renewal at work of illegally dismissed employees, and such court decisions are often not fulfilled or partially performed.

During 2018, according to a court order, the director of the Regional Branch Lviv Railway and the Director of the Department of Passenger Transportation were reinstated. The amount of compensation paid to two dismissed directors amounts to UAH 1.6 million. (\$ 57 thousand).

Due to the lack of an effective mechanism for the inevitability of bringing to disciplinary responsibility and an effective independent body to prevent corruption, there is a growing risk of unauthorized decisions by public officials that conflict with the interests of the company.

Also, there is no system for analyzing and controlling the effectiveness of senior management officials through transparent mechanisms for identifying KPI-indicators.

The effectiveness of the work of managers is determined mainly by the consequential parameters (based on the results of verification of control and audit bodies), or financial indicators. At the same time, effective tools for analyzing organizational and process indicators are not actually implemented.

The functions of the body responsible for monitoring corporate discipline are assigned to different bodies of the company, there is no clear delineation of areas of responsibility and competencies, there is no effective centralized body for the formulation policy of the company's performance.

### Detected cases of corruption abuse

Over 2017-2018, more than 50 criminal cases were opened in connection with the theft of funds of Ukrainian Railways, losses of a state-owned company valued at over UAH 3.0 billion (\$ 107 million).

These cases concern the commission of illegal actions by members of tender committees for the purchase of goods at overestimated cost through a conspiracy with representatives of private structures, improper signing of additional agreements to increase the value of products, procurement of inappropriate equipment, abuse of office, etc.

### Some cases of criminal proceedings:

- **Criminal case number 5201700000000365** (investigation body of the NABU) for the purchase of railroad switch by intermediary scheme at an overestimated cost. The preliminary amount of material losses of JSC "Ukrzaliznytsya" - 800 million UAH.

- **Criminal case 12017220380001883** (investigation body of the SBU, state of emergency) regarding the revealed facts of the system procurement of unsuitable equipment for freight cars for the amount of UAH 400 million.

- Criminal case 5201800000000089 (investigation body of the NABU) regarding the conspiracy of officials of the Branch "Center for Provision Production" and excessive cost in the purchase of cable and wire products, the estimated amount of losses - 225 million UAH.
- Criminal case 5201800000000054 (investigation body of the NABU) for the organization of non-competitive procedures procurement of oils and lubricants. The sum of estimated losses of JSC "Ukrzaliznytsya" - 250-300 million UAH.
- Criminal case 42016000000002788 (investigation body of the GPU) regarding the organization of embezzlement of 70 million UAH. by transferring funds for fictitious repairs of rolling stock, which in fact were carried out by the structural units of Ukrzaliznytsia without the involvement of outside organizations at their own expense.
- Criminal case number 42017201010000064 (investigation body of the NP) on the organization of conspiracy by the leadership of the branch "Darnytsky car repair factory" with representatives of private business entities on the supply of goods at an overvalued cost. Estimated amount of losses is 150-200 million UAH.
- Criminal case 42018000000002784 (investigation body of the NP) regarding organization of money laundering during the purchase of wooden sleepers in the amount of 174 million UAH.
- Criminal case 42018000000003032 (investigating body of the NP) payment for the fictitious performance of works by LLC "Rileyd" during the construction conjugation of the "Kyiv-Boryspil Airport", the amount of estimated losses - 20.4 million UAH.
- Criminal case 42017040000000423 (investigation body of the SBU, NP) for the purchase of unsuitable brake equipment of railway rolling stock for over 20 million UAH.
- Criminal cases 12017000000001562 and 42016000000002980 (investigation body of the SBU, NP) regarding the organization by the Deputy Director of the Locomotive Household Department of the purchase of unsuitable locomotive equipment for over 100 million UAH.
- Criminal case 52017000000000065 (investigation body of the NABU) for the conclusion of additional agreements to raise diesel fuel prices, which exceeded market indicators by UAH 90 million.
- Criminal case 42018100000000018 (investigation body of NP) for payment of non-fulfilled services for anti-corrosion coating of Darnytsky bridge for over 100 million UAH.
- Criminal case 42017000000000766 (investigation body of the GPU) regarding the organization and conduct of employees of the Regional branch of "Lvivska Railways" procurement of goods that exceeded the needs of production by 280 million UAH.
- Criminal case 12017140060004523 (investigation body of the NP) regarding non-compliance with the requirements of the State Tax Administration and not termination of contracts with the intermediary company LLC "Sota Ukraine", determined by the winner of procurement for the amount of 70 million UAH. in violation of the law.
- Criminal case 42017010000000017 (investigation body of the NP) for the purchase of UIC-60 rails for overpriced value and tax evasion. The sum of estimated losses of JSC "Ukrzaliznytsya" - 50 million UAH.
- Criminal case 32017100110000004 (investigation body DFS) to pay 108 million hryvnia for contracts with fictitious business entities for which there are no objects of taxation.
- Criminal case 22016000000000091 (investigation body of the GPU) regarding the arrest when receiving a bribe in the amount of 300 thousand dollars head of the internal audit department of Ukrzaliznytsia with the assistance of appointment.
- Criminal case 52017000000000522 (investigation body of NABU) regarding unreasonable untimely payment of bills under the loan agreements of Southern Railway and Southwest Railways with PJSC Prominvestbank, which resulted in overpayment of UAH 205 million. penalties.
- Criminal case 42018000000002785 (investigation body of the DBR) regarding the conspiracy of railway officials with the representatives of LLC "PUSK" for the conclusion of contracts for 22 million UAH.
- Criminal case 42018101090000078 (investigation body of the NP) regarding illegal actions of employees of the branch of the "Center of provision for production " during the purchase of spare parts for passenger coach for over 12.29 million UAH.

Within the framework of open criminal cases, signs of functioning of systems of the fictitious segment of enterprises on withdrawal of the company funds are revealed; purchases of goods and services at prices that exceed market indicators or are economically unjustified; causing material damage through irrational use of public funds and property; Seals of the Locomotive Department of Ukrzaliznytsya JSC were revealed at the office of the private entrepreneur of Ukrtransklad NPP; other links between the officials of Ukrainian Railways JSC and private entities whose purpose is unlawful appropriation of the funds of the state company.

The crimes of officials of Ukrzaliznytsia, which include abuse of office and extortion of unlawful benefits, in particular, by such officials as the deputy head of the legal department, the head of the department of property resources, the deputy head of the locomotive economy, the deputy director of the Branch "Service Center", an official of the Branch "Center of construction and assembly works" and others.

There were reports of suspicion of at least 24 officials of the Ukrainian Railways, in particular 6 heads of departments of JSC "Ukrzaliznytsia", 4 managers of affiliated companies, 14 high-level employees of branches. According to analysts of the "Railway Without Corruption", the total amount of public funds lost by Ukrzaliznytsya JSC from corruption-related factors and ineffective management is from UAH 5 to 10 billion. per year.

JSC "Ukrainian Railways" demonstrates a low level of resistance to abuse and company's property, financial and reputational losses. The organization and implementation of corruption schemes is a consequence of the conspiracy and activities of officials aimed at creating prerequisites for stealing money from the company or lobbying for the interests of third parties. This process is stimulated by the lack of effective mechanisms of prosecution of officials of PJSC "Ukrzaliznytsya" who committed actions, contrary to the official interests and the presence of the organizers and "guarantors" of illegal transactions in the management departments and affiliates.

The high number of opened criminal proceedings concerning abuses and theft of property committed by officials of Ukrainian Railways shows a significant negative balance in the area of counteraction to corruption-related manifestations and negative consequences for the company.

Corruption remains a major challenge for reforming the company and its renewal.



# HUMAN RESOURCE POLICIES

The staff of JSC "Ukrainian Railways" is 260 thousand people. Of these, 99% are employees of the company's branches, among which the company's transportation and service functions are distributed. At the same time, the company maintains an outdated principle of regional division of functions between regional branches, which are six in the structure of the company.

Such a division was formed in the times of the Soviet Union because of the length of the railways. Most modern railways don't have a regional distribution but have a clear division of functions (freight transport, passenger transportation, locomotive services, etc.).

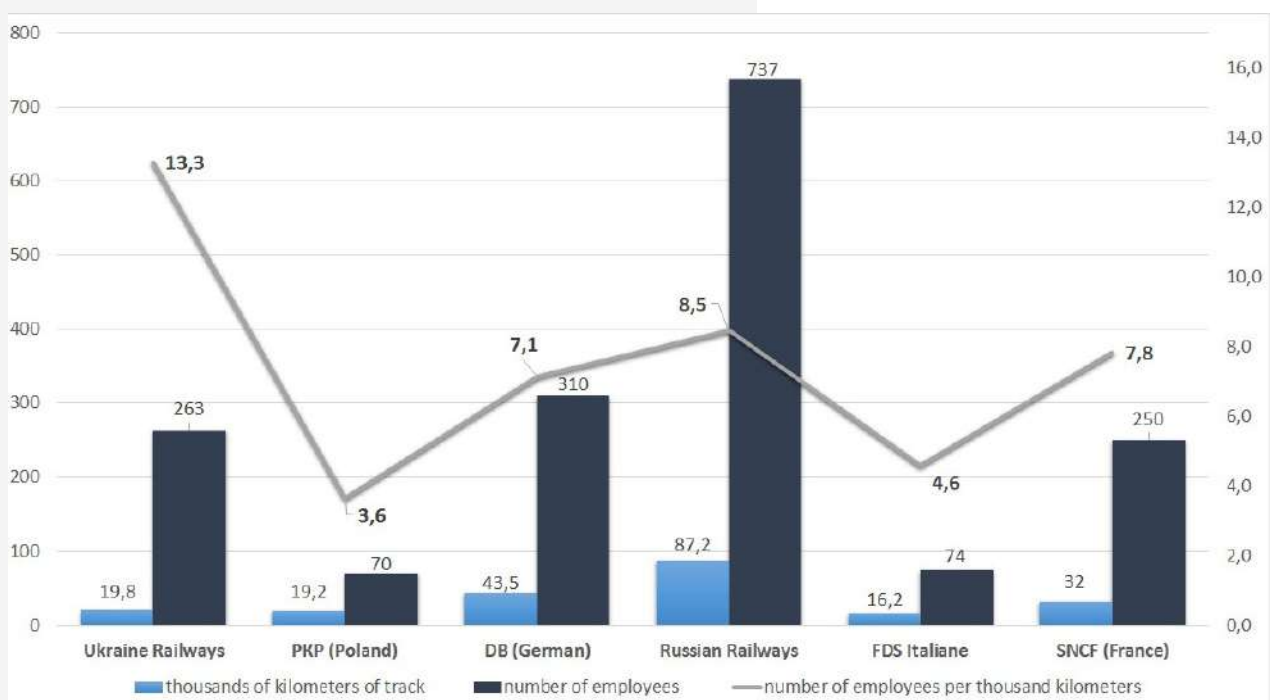
The complexity of the structure of the "Ukrainian Railway" leads to not operational control and inefficient management of the company's production.

The average service arm of one regional branch is 300-500 km. Which leads to frequent changes in the traction rolling stock, possible downtime of freight trains and other negative consequences. At the same time, geographical data of the country allows in most cases to provide the organization of flexible or extended service area from the place of formation of the train to the destination point.

The existence of structures that duplicate each other's functions leads to an overload of the administrative and managerial segment of the company and the overhead of maintaining of the administrative staff.

Due to the double division of the structure of the company by function and regional principle, the number of railway workers per thousand kilometers of roads significantly exceeds the same indicator of other railways:

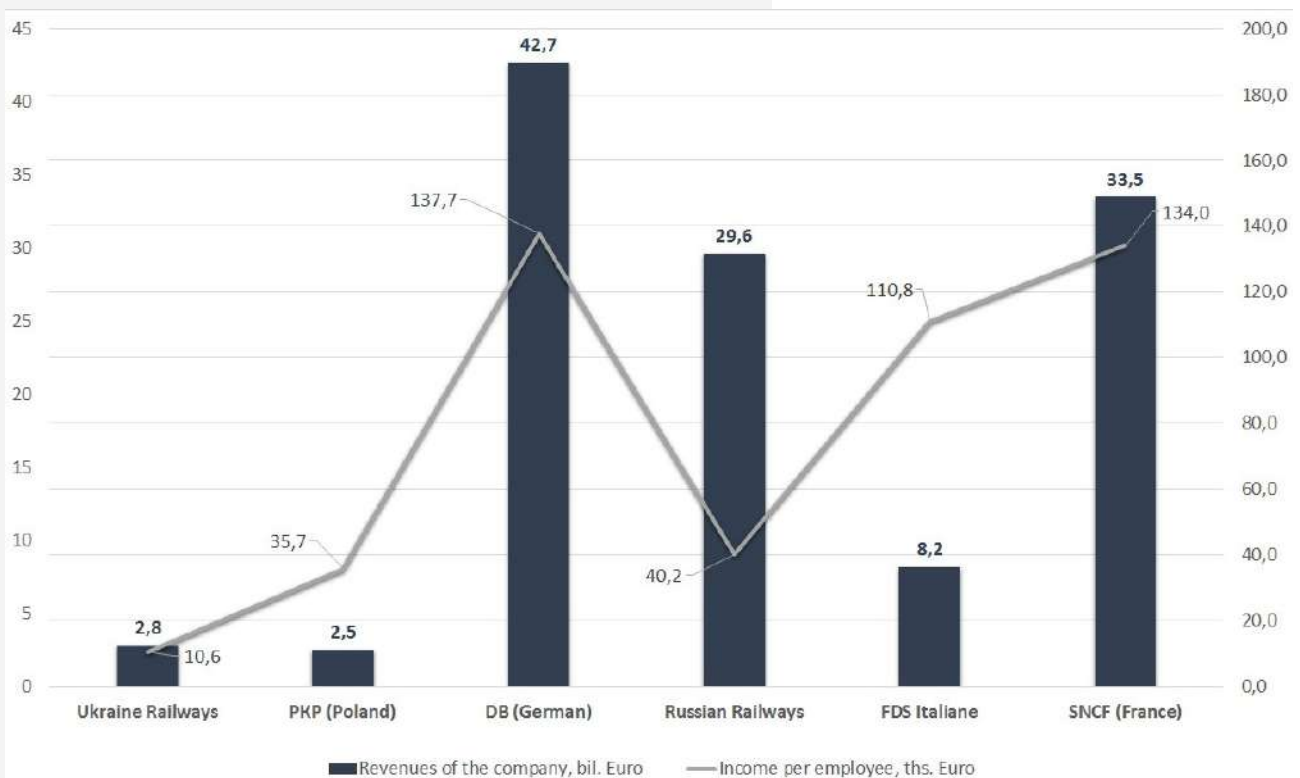
	thousands of kilometers of track	number of employees, ths.	number of employees per thousand kilometers
Ukraine Railways	19.8	263	13.3
PKP (Poland)	19.2	70	3.6
DB (German)	43.5	310	7.1
Russian Railways	87.2	737	8.5
FDS Italiane	16.2	74	4.6
SNCF (France)	32	250	7.8



The average number of employees per thousand kilometers of tracks for the "Ukrainian Railway" is 1.5-2 times higher than similar figures from other railways in Europe.

The total staff of the "Ukrainian Railways" exceeds the number of employees of the railways of France, while the length of the service lines of SNCF 1.6 times exceeds the length of the tracks of the "Ukrainian Railway". The revenue of SNCF is € 33.5 billion in 2017, which is 12 times higher than the level of Ukrzaliznytsia's profits (2.8 billion euros).

	Annual incomes, billion euro	number of employees, ths.	Income per employee, ths. euro
Ukraine Railways	2.8	263	10.6
PKP (Poland)	2.5	70	35.7
DB (German)	42.7	310	137.7
Russian Railways	29.6	737	40.2
FDS Italiane	8.2	74	110.8
SNCF (France)	33.5	250	134.0

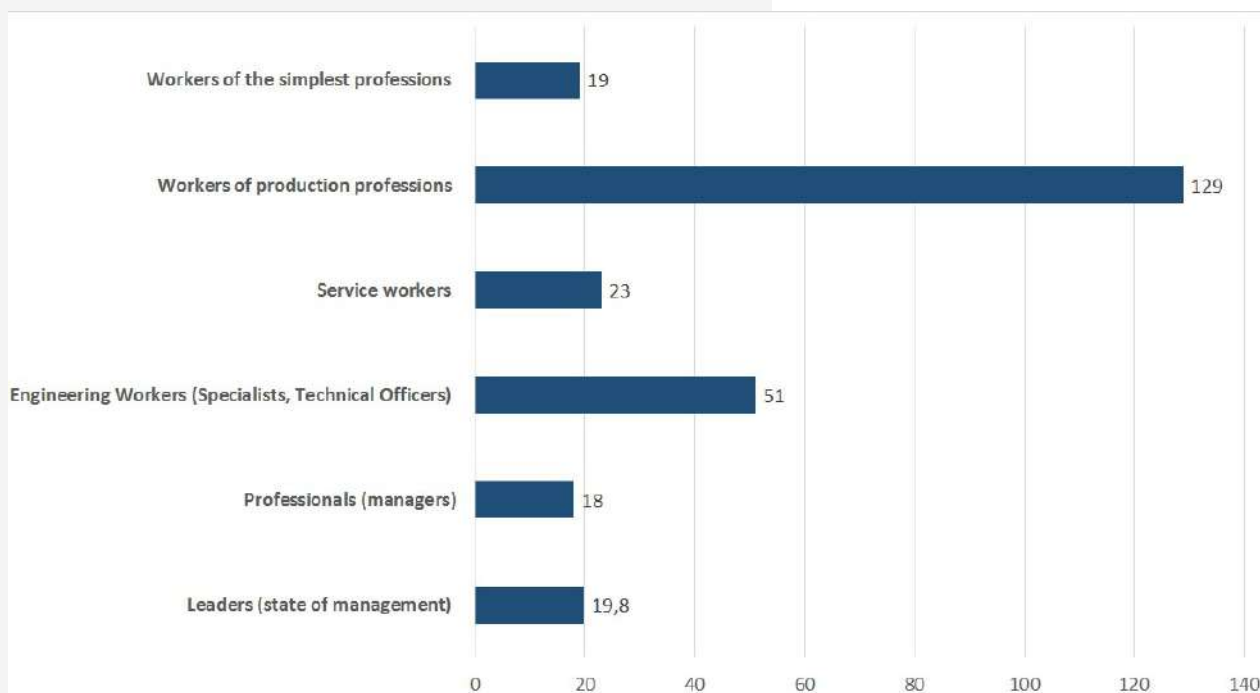


The reduction of the volume of transportation of the "Ukrainian Railway" makes the system of company management ineffective, which significantly outweighs the company's production staff.

In 2018, the division of the staff into employee categories is as follows:

Type of worker	Number, thousand people	%
Leaders (state of management)	19,8	7,6
Professionals (managers)	18	6,9
Engineering Workers (Specialists, Technical Officers)	51	19,6
Service workers	23	8,9
Workers of production professions	129	49,7
Workers of the simplest professions	19	7,3

Type of worker Number, thousand people



Thus, out of a total staffing of 260,000 employees, about 20,000 employees carry out management and decision-making functions, and about 70,000 engineering and technology workers and mid-level managers. Only 130 thousand (less than 50%) are employees directly involved in the production of products and services of Ukrainian Railways JSC (main production categories).

The relevant organizational structure of the company indicates the overload of the administrative and managerial segment in relation to the main categories of employees, arising from the ineffective organization of the company, the existence of duplication and fuzzy separation of functions and tasks between different units. The company's organigram implies duplication of functions and the lack of a clear demarcation in ensuring the performance of the company's tasks between its structures

In 2018, it was planned to separate sectors of locomotives and passenger transportation into separate units according to the model of European railways. However, only the "Passenger Company" branch was actually created. But, the creation of this branch did not lead to a reform of the passenger transport system, only increased the existing management staff. Functions for the provision of passenger transportation remain distributed among the regional branches, the "Passenger Company" branch and the departments. There is a duplication of functions of separate structures of the company.

Transparency and openness in recruitment and performance evaluation of employees' responsibilities play an important role in managerial processes.

One of the main priorities of the "Ukrainian Railways" reform in 2017 was the provision of selection of company executives on the principle of transparent and open competition. However, in 2018, this strategy is not implemented, and the appointment of company management occurs in opaque conditions and with high reputational risks.

It confirms the facts of approval of employees with a dubious reputation and without proper experience and employees who, during a short period of time, were exposed to abuse of office.

So during the year about 15 officials of "Ukrzaliznytsia" were suspected of organizing the loss of company funds in particularly large amounts. Among them are the management of affiliates, heads of departments and offices. Criminal proceedings were opened against the director of the Darnytskyi car repair factory branch for the pressure on subordinates demanding to conclude improper contracts with overpriced value.

In general, officials of the "Ukrainian Railway" figure in dozens of criminal cases on the facts of committing unlawful actions that contradict the interests of the company.

The official resource of the company does not contain sufficient information about the company's management, the order of their selection and appointment, compliance with qualification and reputation requirements. The company's website only provides short and general information about the company's divisions.

The selection and appointment of key managers of the company is obscured and non-public. Regarding the appointments, there is no information on the number of applicants for a post and the re-registration of applicants (reiteration procedure).

Thus, there is a high probability of "manual" appointment of employees who do not meet the competitive selection and qualification requirements of the company, and personnel decisions contain large corruption-related risks.

Due to the lack of the Code of Corporate Ethics, the system of reputational and qualification requirements for the management staff and the authorized compliance authority, an effective mechanism for assessing the efficiency of work and the quality of performance of official duties was not provided. The control over the effectiveness of the managers' work is non-systemic and does not create prerequisites for the qualitative performance of functions assigned to the official, and the assessment of the work of the management staff is non-public and often causes considerable dissonance in society.

Numerous allegations of the company of appointments to management positions not based on the principle of personnel qualification, but on the principle of coordinating candidates with specific officials, including "quotas" of persons who allegedly carry out secret oversight over the activities of Ukrainian Railways. This is contrary to the interests of the company and does not meet the current standards for the adoption of personnel and management decisions.

The overall picture of the personnel policy of the company emphasizes the importance of openness and transparency in the adoption of management decisions, in particular the appointment of heads of departments and affiliates of the company. It is necessary to create transparent and public mechanisms for competitive selection and rating, respecting the principle of independence and impartiality of selection and objectivity commissions during the evaluation of candidates (with the maximum involvement of independent representatives and professional selection of applicants).



# PUBLIC PROCUREMENT

In the structure of JSC "Ukrainian Railway", the functions of organization and carrying out procurement are divided between more than 30 affiliates, who independently formulate a procurement plan and announce their conduction. At the same time, among the branches there is the main organizer - the "Center for providing production", which manages the largest amount of purchases.

In this, the formation of production needs and requirements for the required products is complex and does not contain a clear demarcation of functions.

The definition of the production needs is duplicated by the branches, departments and offices in the area of responsibility of which structural units are located. The process of matching the current procurement plan with the real production needs is non-transparent and involves subjective factors.

There is no clear principle of procurement differentiation, which is carried out by the main organizer (Branch "Production Provision Center ") and the rest of the organizers. Responsibility for the quality of procurement is distributed between departments, managements, services, which determine the primary production need and technical, qualification product requirements and organizational units that provide a direct process of planning and carrying out procurement.

The imposition of discriminatory requirements and restrictions on products and participants is often formed at the stage of preparation of tender documentation by the departments and services of the company, which in the future forward the established requirements to the tender committees of customers.

Under such a system there are factors to provide unwarranted advantages to certain market participants. At the same time, there is no institute of responsibility of officials for the quality and efficiency of planning and implementation of procurement.

In this situation, the Tender Committee primarily acts as a technical organizer who is not responsible for the content or nature of the tender requirements.

In such circumstances, there is a high risk of giving preferences to individual market participants, making purchases of certain product groups in the interests of certain suppliers more than existing production needs. This is confirmed by numerous open criminal cases of corruption in the procurement of Ukrainian Railway, the presence of 980 complaints by participants in 2018 to the Antimonopoly Committee about the discriminatory requirements of the organizers during the procurement process (the highest rate among all customers in Ukraine). And also, other negative organizational indicators - low competition, high percentage of disqualification of participants, low savings.

The company needs a system of transparent and objective forming of production needs and procurement planning, as well as institutional control over the compliance of tender documentation with the interests of the company, planning and procurement.

In addition, the company lacks market monitoring mechanisms to identify potential suppliers, in order to inform them about company needs and increase competition in tendering. The lack of a system of open dialogue with the market to determine transparent and effective terms of cooperation is hindered by the improvement of the quality of the company's purchases.

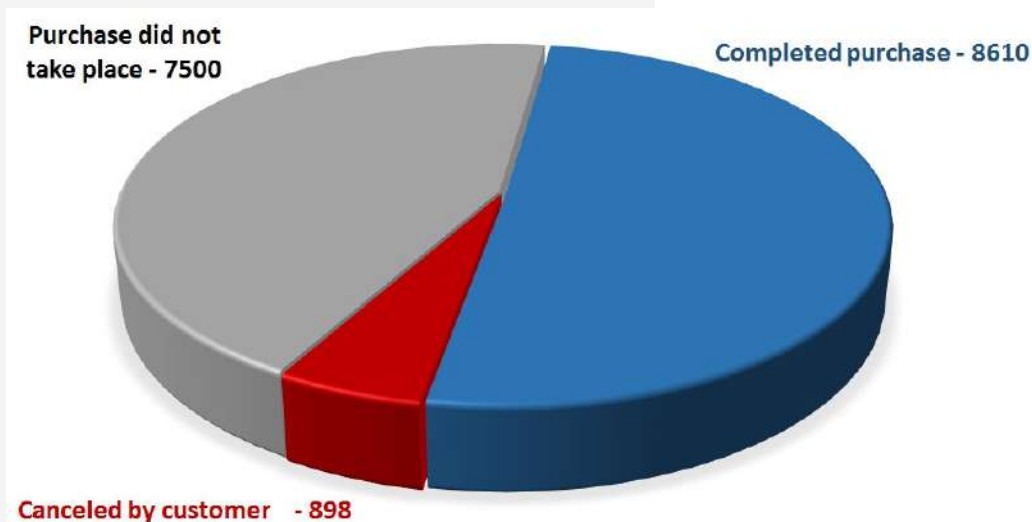
## **PROCUREMENT VOLUMES:**

In 2018, 19.3 thousand tender procedures for the total amount of UAH 42.3 billion were announced by customers of JSC "Ukrainian Railways".

### **Procurement Results:**

- resulted in the signing of the agreement - 8 610 tenders in the amount of 27.93 billion UAH.
- canceled by the customer - 898 tenders in the amount of 3.57 billion UAH.
- did not take place due to the absence of at least 2 admitted participants - 7,500 tenders for 8.32 billion UAH.

### Procurement Results:



### Information: ProZorro

Thus, 49.5% of the conducted tenders were unsuccessful and only 50.5% were concluded.

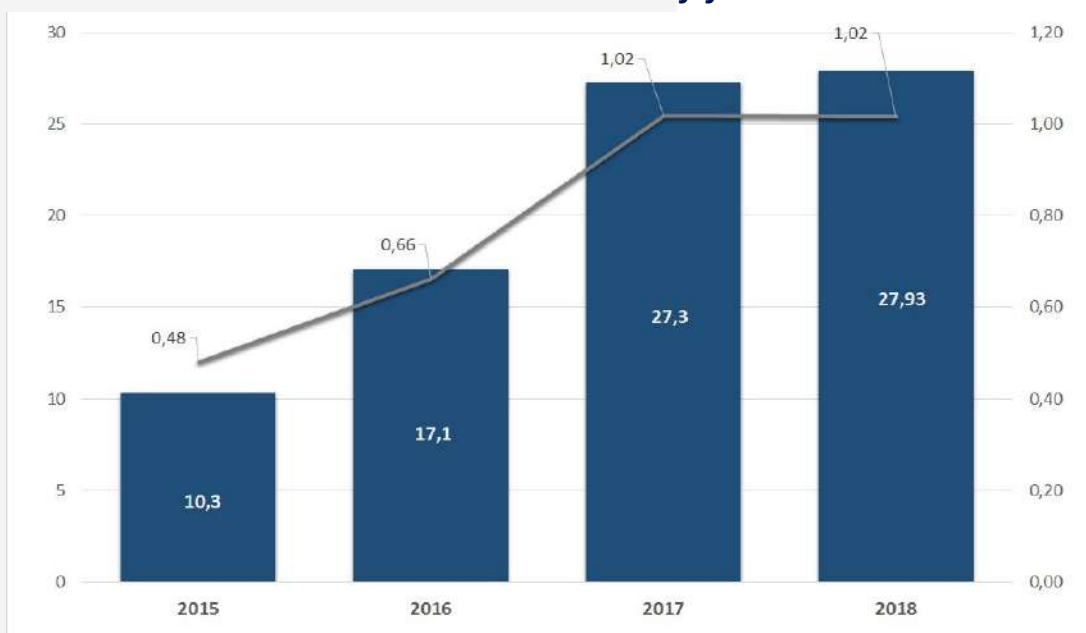
While the average of completed purchases among all customers in Ukraine in 2018, according to ProZorro, is 86.2% and 13.2% is unsuccessful.

In the context of the expected cost of procurement, the purchase of goods for a total amount of UAH 27.93 billion was successfully carried out. (69%). There were no purchases for the total amount of UAH 11.89 bln. (30%), of which purchases of UAH 3.57 bln. canceled by the customer for an independent decision.

The high percentage of unsuccessful purchases indicates the low activity of market participants in the purchases of Ukrainian Railways JSC and the poor planning of procurement of the company. Both factors are negative in the issue of forming a positive image of Ukrainian Railways JSC as a potential market for producers and suppliers of products.

The general indicator of the volume of completed purchases remained almost unchanged from the previous year in both the national currency and the dollar, USA. In general, Ukrzaliznytsya in 2018 did not fulfill the procurement plan by 25% (planned procurement at the level of 37 billion UAH / actual level - 27.9 billion UAH). In US dollars, the annual volume of purchases over the past 4 years has increased 2.1 times - from \$ 0.48 billion to \$ 1.02 billion a year.

### Procurement volumes by years:

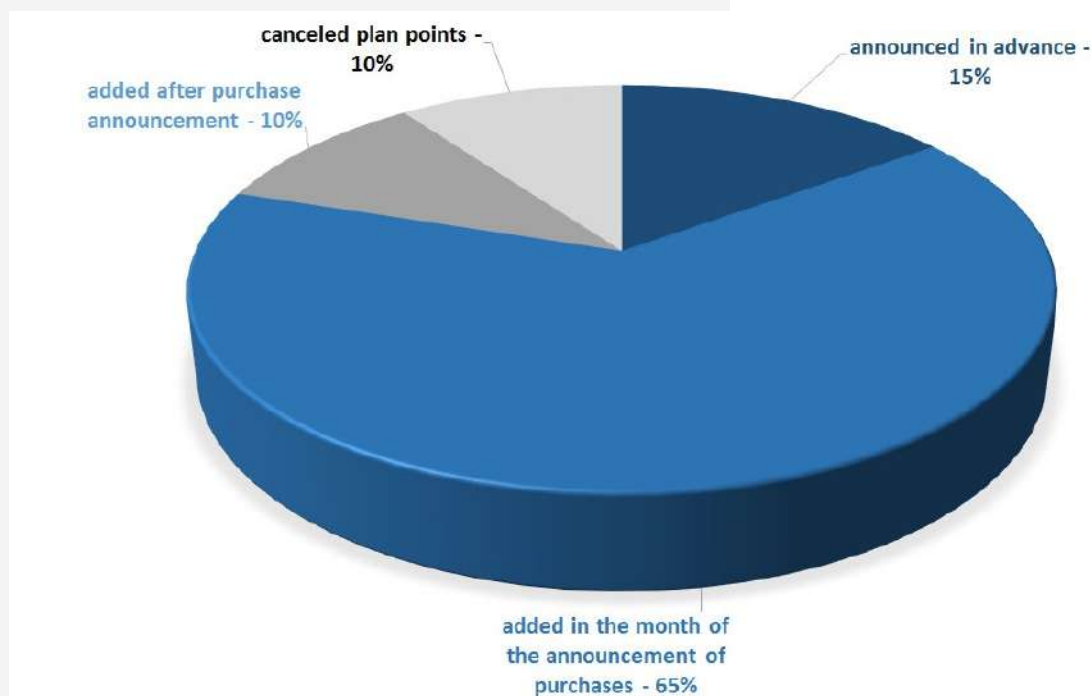


### Information: ProZorro

## PROCUREMENT PLANNING:

JSC "Ukrainian Railways" demonstrates a low level of procurement planning quality. So, in 2018, requisitioners of Ukrzaliznytsia excluded 10% of items of the plan, relative to the initial annual procurement plan. 19% of the points of the plan were made with changes to the initial annual procurement plan. 75% of the points were entered the procurement plan less than a month before the announcement of the procurement procedure, including 10% of the procedures were included in the procurement plan after the announcement of the procurement procedure.

### Procurement planning



Information: ProZorro

At the same time, in accordance with the Law of Ukraine "On Public Procurement", the annual procurement plan is a decisive document in the process of procurement, aimed at the early notification of market participants about the needs of the customer in order to production plan and forecast of activity. Procurement, which is not provided for by the annual procurement plan, is prohibited.

## TYPES OF PROCEDURES:

In 2018, 6.4% of purchases for the total amount of UAH 2.27 bln were conducted under non-competitive procedures - tentative procurement, reporting procedure for a contract, negotiation procedure. One of the reasons for using negotiated procedures is bidding, which does not occur twice due to insufficient number of admitted participants. As a result, the customer has the right, in accordance with the Law of Ukraine "On Public Procurement", to make a direct contract with a single participant.

At the same time, the low number of participants admitted to trading can be explained both by objective and artificial factors.

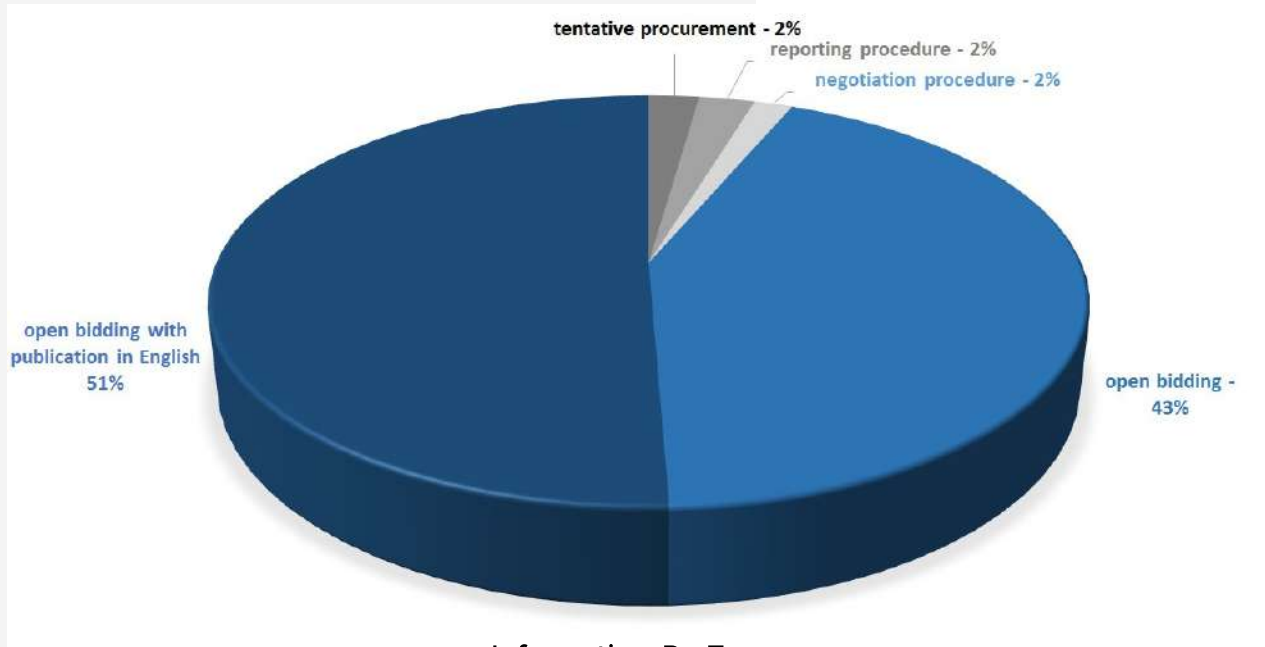
Objective factors are the limited range of suppliers of certain types of products procured for the needs of JSC Ukrainian Railways.

### Non-objective (artificial) factors are:

- low quality of the advertisement (not clearly indicated the classification of the goods, the name; the pooling of a large number of different types of goods in one lot of purchases; excessive formal requirements). 68.8% of all procedures of PJSC "Ukrainian Railways" for 2018. according to the module bipro.prozorro analysts have low quality of the ad;

- high percentage of disqualification of participants - 24% of all proposals submitted by participants in tenders of Ukrzaliznytsia;
- inconvenient conditions for the supply of goods (requirement for the supply of goods up to 30 days from the request of the customer at significant volumes of purchase; long-term contracts with static prices, without considering fluctuations in pricing factors of the market; the requirement to supply products to different regions of the country in one procedure);
- negative reputation of JSC "Ukrainian Railways" as a customer.

### Types of procedures



Information: ProZorro

### SAVING:

JSC "Ukrainian Railways" has a significantly lower savings rate than the average in Ukraine - 3.3% in 2018, with an average of 4.3% in Ukraine.

Thus, the rate of savings in tenders of JSC "Ukrainian Railways" is 25% worse than the average customers of ProZorro.

The reasons for this are low competitive activity (79.03% of tenders of Ukrzaliznytsia have a minimal decrease in prices) and the presence of anticompetitive concerted actions (about 40% of tenders have signs of coordination of actions of participants).

The worst suppliers in terms of saving to relatively expected value are:

- **PJSC "Kryukiv Carriage Works"** (wagons, diesel trains, equipment): the sum of contracts for 2018 - UAH 2 708 million, average savings of 0.02%;
- **Metinvest-SMC Ltd.** (metal products, rails): the sum of contracts for 2018 - UAH 2 357 million, average savings of 0.5%;
- **LLC "Krendls"** (switching transfers): the sum of contracts for 2018 - 766 million UAH, the average economy 0.26%;
- **PJSC "Kremenchuk Steel Works"** (details of carriage): the sum of contracts for 2018 - UAH 243 million, average savings of 0%;
- **Star Pack Group LLC** (equipment for freight cars): the sum of contracts for 2018 - UAH 192 million, average savings of 0%;

In most cases, only 2 participants take part in tenders with savings of less than 1% who do not exhibit competitive actions at the stage of the auction and may be associated with dealership or representative interests.

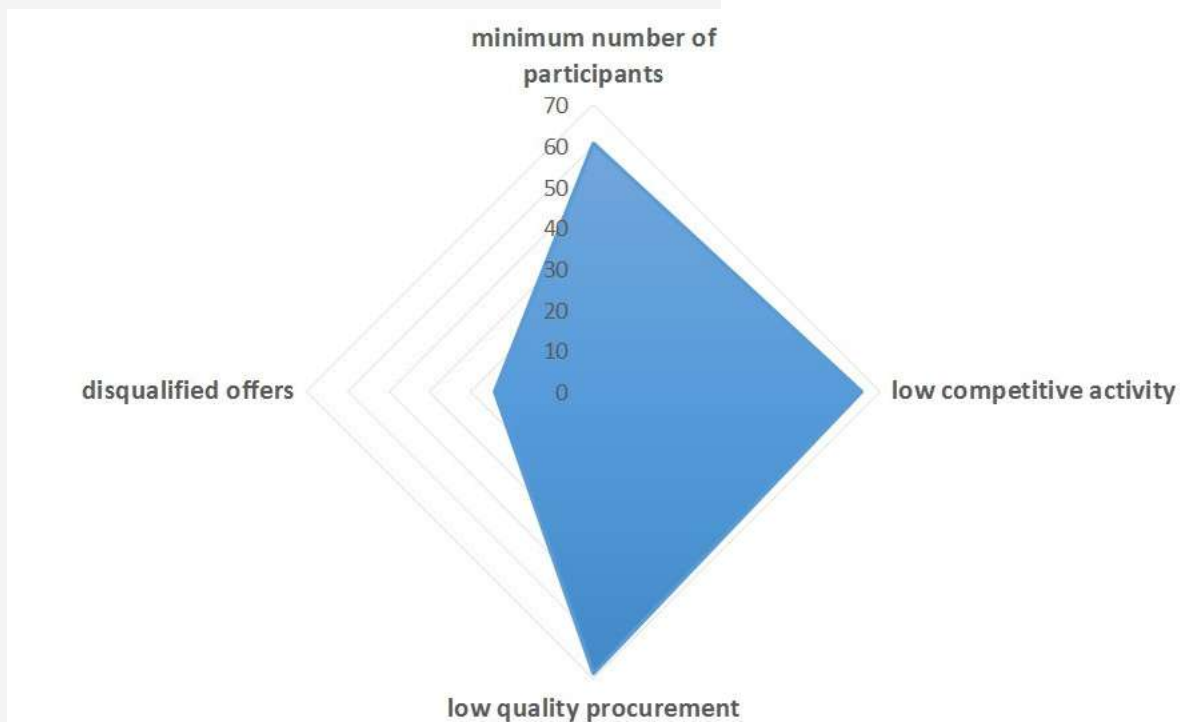
## COMPETITION:

In 2018, at the tenders of JSC "Ukrainian Railways", the average number of participants was 2.7, which is equal to the average for Ukraine in 2018.

In 60.7% of all procedures there is a small number of price unique offers (2 participants per lot).

In 65.4% of the procedures the participant won without the price competition in the auction. That is, during three rounds of the auction, none of the participants reduced the initial prices.

### Characteristics of purchases



Information: ProZorro

In total, in 2018, 6,633 participants took part in the purchases of Ukrainian Railways. Of these, 3,435 participants became the winners of the procedures. Of these, 1198 participants signed contracts for a total amount of more than 1 million hryvnia.

At the same time, 63.8% of all purchases in the number of contracts (UAH 17.8 billion) accounted for 20 largest suppliers.

1% of participants account for 76% of all contracts, while 99% of participants take only 24% of contracts.

Thus, the procedures of JSC "Ukrainian Railways" have a high percentage of monopolization. Most purchases occur without price competition in the auction for the minimum number of participants in the lot. This indicates the ineffective use of the ProZorro platform. The overwhelming number of contracts falls on a relatively narrow range of suppliers.

## DISQUALIFICATIONS:

During the years 2017 and 2018, Ukrainian Railways was a leader in such negative aspects as the number of appeals and the number of disqualifications of participants.

On average, 26% of participants' proposals were disqualified by tender committees, while the average indicative disqualification in Ukraine is within 15%.

Of the total 34,918 price proposals of the participants, 9,067 proposals were declared by customers unsuitable for tender requirements.

In particular, the reasons for the high level of disqualification include excessive customer requirements in terms of approvals, confirmation letters, excessively detailed product requirements and other formal requirements that do not have a decisive impact on the quality of the products offered.

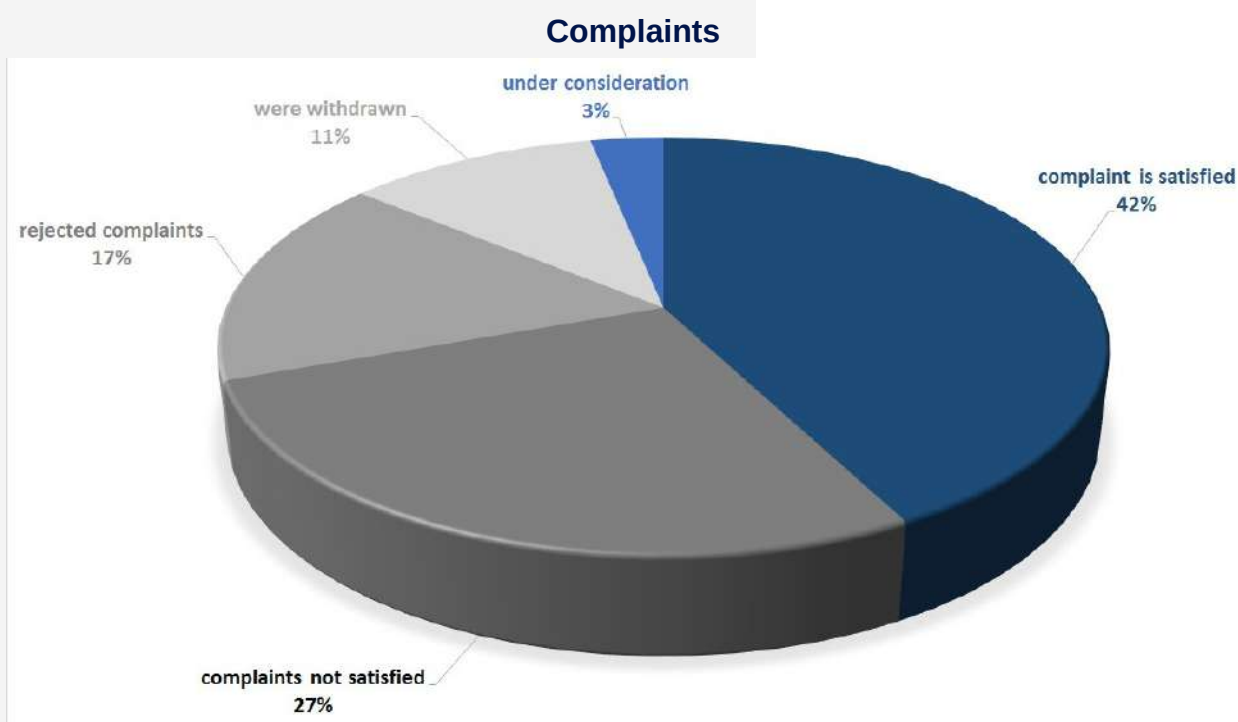
## COMPLAINTS:

The units of Ukrzaliznytsia are the leaders in terms of the level of appeals by the bidders to the Antimonopoly Committee of Ukraine (AMCU) regarding the violation of the rights of the participants.

According to ProZorro, in 2017, 643 complaints to the AMCU board and 2070 claims to customers were filed in auctions of branches and enterprises of JSC "Ukrzaliznytsia". Of which 387 complaints, or 47.2% of the total, were found to be reasonable and satisfied.

In 2018, 980 complaints to the Antimonopoly Committee were filed by the participants of the procurement for violating the participant's rights. By 47% more than in 2017. This indicates an increase in the tendency of discriminatory procurement of the "Ukrainian Railways".

Of these, 415 complaints (41.7%) were satisfied with the appeal body, 266 were not satisfied (27%), 161 were rejected without consideration (17%) and 107 complaints were withdrawn by the complainant (10.7%). 31 complaint is under consideration by the AMCU.



Information: ProZorro

On average, 4.95% of all purchases of the Ukrainian Railways were filed with complaints from participants. While the average for Ukraine is 1.3%. That is, the index of the railroad is more than 4 times the average in Ukraine.

## PROCUREMENT DISTRIBUTION:

During 2018, most of the purchases include fuel and lubricants, transport equipment and construction materials:

**Fuel and lubricants - 10.1 billion UAH.**

**Transport equipment - UAH 9.75 bln.**

**Repair services - UAH 1.6 bln.**

**Construction materials - 1.6 billion UAH.**

**Metal products - 1.15 bln.**

**Construction work - UAH 870 mln.**

**Electrical equipment - 615 million hryvnas.**

**Industrial engineering - 294 million hryvnas.**

**Clothing / Shoes - 276 million UAH.**

**Consultations - UAH 168 mln.**

In this case, individual segments of the supply market are monopolized by individual representatives or groups of individual representatives.

100% of rail products for the needs of Ukrzaliznytsia is supplied by Metinvest-SMC Ltd;

The only supplier of passenger cars and diesel trains is PJSC "Kryukiv Carriage Works";

80% of the metal products is supplied by Sota Ukraine LLC and Alfa Metal Company LLC;

98% of lubricants and oils are supplied by Torum Ltd., Miroil Ltd and LLC "UBSP" Azmol-British Petrochemicals";

100% of street transfers will be provided by LLC "Krendls" and LLC "Dneprozaliznichpostachania";

100% of the freight carriages are delivered by PJSC "Kremenchug Steel Works" and "Azovmash" LLC.

The share of participants who monopolized the supply market of Ukrzaliznytsia accounts for about 10 billion UAH. in 2018, representing 35% of the total supply.

About 30% of winners of the tenders have signs of a fictitious or intermediary segment or are involved in criminal proceedings for theft of funds of the "Ukrainian Railway".

In this case, the preconditions for participation in tenders of JSC "Ukrainian Railways" of fictitious and intermediary business entities, are created directly by the tender committees of the customer during the formation of tender documentation.

Thus, the legislation imposes on the customer the possibility of defining the qualification criteria which the participant of the procedure must meet and the definition of "similar experience", "necessary technical support base", "necessary qualified personnel".

Abuse of the qualification requirements regarding the submission by the party of letters of approval / surveys by the structural units of Ukrzaliznytsia JSC, the availability of certificates and other formal limitations, tender committees do not pay due attention to the requirements of the qualification of the procurement participant and potential risks. Thus, often offers of manufacturers, which are cheaper by 20-50%, are disqualified by the customer and the participant of the intermediary sector is determined by the winner with an uncompetitive price.

The high percentage of contracts with intermediary companies and dubious reputation is a potential risk of loss of funds of Ukrainian Railways JSC, confirming criminal cases opened in 2017-2018, in particular with regard to LLC "Ukrainian Machine-building Technology" and LLC "Technoreelgrup" in relation to detected underground production spare parts of inappropriate production technology, which were sold to Ukrzaliznytsia in the amount of 400 million UAH; LLC "Krendls" regarding unlawful overpayment due to overvalued product costs by 500 million hryvnia in 2017 and other criminal cases. The total amount of estimated losses of the company in which is more than 2 billion UAH.

## **THE MAIN NEGATIVE AND CORRUPT FACTORS IN PROCUREMENT:**

- 1) the detailed characteristics of the procurement subject, which corresponds to an exhaustive list of goods and the lack of justification for the application of such requirements
- 2) requirements for the approval of technological conditions to produce goods with the structural unit of Ukrzaliznytsia and the procedure for admission to the use of products of the railway destination
- 3) requirements for providing feedback on the positive experience of application at Ukrzaliznytsia
- 4) avoiding competitive procurement procedures
- 5) establishment of terms for the supply of products that are insufficient for its production after the conclusion of the contract
- 6) irrational use of funds / purchase of goods in volumes that exceed the need for production
- 7) merging into one lot of purchases of goods produced by different manufacturers
- 8) formation of the expected value over market indicators
- 9) high monopolization of the supply market
- 10) high dependence on political ties and shadow processes



## MAIN TRENDS OF PURCHASES IN 2018:

During 2017-2018, a branch of the "Center for Production" introduced and conducted several tenders for the purchase of diesel fuel with a formulated price adjustment in line with the dynamics of the European fuel market and the rate of national currencies.

Such an event is an important positive step in the formation of transparent principles of predictability of customer-supplier relationships and the achievement of a transparent balance of interests.

At the same time, it should be noted that the main principles of public procurement are efficiency and achieve maximum savings. According to the tenders for the purchase of diesel fuel during the year 2018, the average price per unit of production for JSC Ukrainian Rail Company exceeded the value of diesel fuel on the wholesale market of Ukraine by 0,52%.

At the same time JSC "Ukrainian Railways" is the largest customer of diesel fuel in Ukraine, which should help to set procurement prices 2-5% below the level of prices in the wholesale market of the country.

Also, in 2018, Ukrzaliznytsya significantly reduced the practice of unreasonable price increases, after the conclusion of the agreement through additional agreements. Together with the portal of public funds use of the Ministry of Finance of Ukraine, the disclosure of information about all transactions of JSC "Ukrzaliznytsia" in a public resource is made, which improves the publicity of the stage of implementation of the agreements.

However, the overall procurement process of Ukrzaliznytsia JSC remains unsatisfactory, while indicators of openness, efficiency, competitiveness and non-discrimination are one of the worst among Ukrainian customers. So "Ukrainian Railways" signed an agreement on the development of a ticket service for Kyiv-Boryspil Airport in a non-competitive procedure for over UAH 21 million. At the same time, the company has an existing ticket service for all railroad routes, which cost only 6.5 million hryvnias. The conduct of the said procurement was found to be unlawful by the State Audit Office.

During the procurement of oils and lubricants by 600 mln. the "Ukrainian Railways" applied restrictions to tenderers through the procedure of admission for the use of the specified products on the railways. As a result, the purchase of oils and lubricants was carried out in a limited range of intermediaries of a joint producer at prices that exceeded the market level by 30%. At present, NABU investigates the existence of a crime in these actions.

In 2018, "Ukrainian Railways" continued the practice of concluding contracts for the railway supply of crossings by intermediary firms. According to the investigation, the only producer of these products in Ukraine sells these goods at prices that is 35-40% lower in relation to the prices for which they purchase Ukrainian Railways.

In general, the estimated amount of losses of the "Ukrainian Railways" through the conclusion of intermediary contracts with an overvalued cost is about 800 million UAH. (\$ 28.5 million) for the period from 2016 to 2018.

In February 2018, the Security Service of Ukraine reported the detection of underground shops for the production and sale of "Ukrainian Railways" of unsuitable goods worth UAH 400 million. (\$ 14.3 million) per year. Despite this, in 2018, Ukrainian Railways has continued to buy spare parts of freight cars from companies that are involved in this criminal case.

During checking of the contractors of the "Ukrainian Railways", more than 50 companies were found that are not at the place of registration and there are no signs of their business activity. There are risks that the listed companies operate for the implementation of intermediary schemes for the purchase of goods at overpriced value and withdrawals from the company.

# ACTIVITIES OF THE COMPANY'S MANAGEMENT

The main governing body of the JSC "Ukrainian Railways" is the board of the company, which consists of 6 members and the chairman of the board. The board controls and organizes the work of sectoral departments, offices and agencies that provide policy control and organize the work of sectoral and regional branches of the company.

Also, the authorities control the industry enterprises, 100% of which belongs to Ukrainian Railways. These are 3 locomotive repair plants, 1 car repair plant and 3 factories for the production of railway machinery and equipment.



## **Yevgeny Kravtsov, Chairman of the Board.**

Sphere of control: corporate governance, property policy, reforms, economic security, internal audit and international cooperation

### **Implemented programs:**

- The company was reorganized into a joint-stock company, changed the powers and functions of the supervisory board, the principles of supervisory control over the effectiveness of the board
- A contract with General Electric was signed, the first 15 locomotives were delivered
- The study of the market for construction of electric locomotives began
- Achieved the forecasted financial result for the year (implementation of the financial plan in terms of revenues - 97%)
- A "Passenger Company" branch has been created.

### **Negative results:**

- Gradual decrease in the position of rail transport in the field of cargo and passenger transportation of the country
- Reducing the efficiency of freight traffic (turnover of the car) by 11.8% and the lack of progress in improving the quality of freight traffic
- An independent "Compliance Office" wasn't created, the formation of which was announced in 2017
- The reform of the public procurement system and the full assessment of the quality of the company's procurements announced in early 2018 have not been implemented. There are no tools for effective monitoring and increasing the efficiency of public procurements
- The proper level of economic security and internal risks are not ensured. There are numerous criminal cases in the aftermath of the loss of company funds. The company's total losses from corruption abuses are estimated at UAH 4 billion. per year.
- No announced sectoral division of the company in the main areas of activity, there is no clear separation of functions. Creation of the "Passenger Company" branch has not been completed by a full reform in the field of passenger transportation services. Passenger transportation functions remain shared between regional branches, departments and the "Passenger Company" branch
- The personnel policy of the company has high reputation and corruption risks, the process of selection and appointment of directors of the company is opaque



### **Irenaueus Vasilevsky, board member**

Sphere of control: Production and repair (freight wagons and locomotives)

#### **Realized steps:**

- There is a steady dynamic of production of freight cars at its own enterprises
- Overhaul of 130 locomotives was carried out
- The study of electric locomotive market offers has begun

#### **Negative results:**

- Revealed facts of systematic procurement of unsuitable equipment for freight cars for the total amount of UAH 400 million.
- Most purchases for the construction and repair of freight wagons are carried out at intermediary firms at an overestimated cost. There are numerous criminal cases in the procurement of equipment for the repair and construction of freight wagons and locomotives. The specified segment is the most corrupt in the public procurement system
- The rates of recovery and construction of freight wagons and locomotives do not correspond to the rates of wear of the rolling stock. The level of demolition of the fleet of freight cars is about 70%, locomotives - over 90%.
- Low efficiency of locomotive repair plants, failure to meet the needs of the company in qualitative and timely performance of major repairs
- The strategy of renewal of the park of main locomotives has not been implemented. The planned recovery rate is 6% per year, while the actual rate is 2.9%.
- There is no strategy for modernizing the production base and introducing modern technologies
- There is no long-term strategy for company development in the technical sector



### **Alexander Buzhor, board member**

Scope of Control: Accounting, Economics and Finance

#### **Realized steps:**

- The company's credit rating has been raised to the level B- / CCC +
- implementation of a system of publishing company's transactions in public access
- Achieved the forecasted financial result for the year (implementation of the financial plan in terms of revenues - 97%)
- The loan portfolio of the company has been reduced

#### **Negative results:**

- The implementation of the capital investment program is not ensured. The program is implemented only by 67.3%
- The assets of the company have a high level of wear and tear and a negative dynamics of cost reduction
- High percentage of foreign currency loan portfolio (96%), which affects the forecasting of credit policy due to the possibility of exchange rate differences
- There is no system for analyzing and evaluating the efficiency of using credit funds and achieving planned economic and technical indicators
- There is no long-term policy of the company in the financial sector



### **Sergei Mikhalechuk, Board Member**

Scope of control: Passenger transportation

#### **Realized steps:**

- Introduced 5 new international routes
- Recovered 126 passenger cars
- A "Passenger Company" branch has been created.

#### **Negative results:**

- Reducing the position of rail transport in the passenger transport market in relation to other modes of transport
- Low passenger transportation service in most routes
- The rates of recovery of passenger cars do not correspond to the rates of wear. Wear and tear of vehicle fleet is 93%
- The announced system of updating the principles of cleaning passenger cars and catering in trains is introduced only on individual routes
- High monopolization of the market for supply and repair of passenger cars by private companies, failure to take measures to expand competition in the supply market
- High level of corruption risks in the system of purchases of equipment and spare parts of passenger cars, there are criminal cases on causing damage to the company due to abuse of company officials
- There is no long-term strategy for the company's development in the passenger transport sector
- The establishment of the "Passenger Company" branch did not end with a complete reform in the field of passenger transportation services. Passenger transportation functions remain shared between regional branches, departments and the "Passenger Company" branch



### **Remigius Pashkevich, Board Member**

Sphere of control: infrastructure and tracks

#### **Realized steps:**

- 555 km of roads were renovated and overhauled
- The Beskydy tunnel has been launched
- The Boryspil Express has been launched
- Electrification of the Plotki-Zolotnishino site was carried out

#### **Negative results:**

- The recovery rate is only 6% of the total needs. About 8,000 km of roads require major repairs
- There is no long-term strategy for reforming the company's infrastructure and introduction of high-speed traffic
- Procurement of companies in the infrastructure sector is monopolized by a narrow range of suppliers, the company has not implemented steps to attract new market participants
- There are open criminal proceedings for the procurement of elements of the track through fictitious companies, at inflated prices. The total amount of losses of the company in the procurement of elements of the tracks reaches more than 500 million UAH. for 2017-2018 years



### **Zeljko Marcecke, Board Member**

Sphere of control: Human resources and social policy

#### **Realized steps:**

- The wage level for most workers has been revised
- The financing of trade union organizations and social payments of employees are provided
- The financing of construction of social housing for families of railwaymen is being implemented

#### **Negative results:**

- Changes in the remuneration system are implemented asymmetrically for different categories of employees. Official salaries of company executives increased by 20-150%, while for employees of the main occupations the increase was only 5-7%. The high level of social tension in the state of the company due to the high wage gap between production professions and management staff
- The company does not have an effective code of corporate ethics and standards of conduct, there are facts of abuse of duties by officials.
- The system of open and competitive selection of candidates for management positions in the company has not been introduced. There are high reputational risks and opacity of staff selection
- In fact, the reform of the management system and organization of the company has not been implemented



### **Mark Robert Zalessny, Board Member**

Scope of control: Freight transportation

#### **Realized steps:**

- Deregulation of the cost of use (lease) of wagons JSC Ukrainian Railways
- Organized measures to increase container transportation

#### **Negative results:**

- There is still negative dynamics of volumes of freight traffic and the share of rail transport in the country's freight market
- Low quality of service - the company satisfies only 52% of the customers' requests for freight transportation
- Significant decrease in the efficiency of cargo transportation - the average turnover of the car is 10.3 days (11.8% slower than in 2017)
- Termination of implementation of the system of automated distribution of empty freight wagons, which leads to corruption-related risks in satisfaction of consignors' applications
- There is no long-term strategy for the company's development in the freight transport sector, the introduction of bimodal and intermodal transport modes
- Two ferries, owned by Ukrainian Railways, were not launched despite the payment for their repair and reconstruction services.

# KEY DIRECTIONS FOR IMPLEMENTATION OF REFORMS

## **Financial security**

In order to realise the policy of protecting the interests of the company, it is necessary to create an independent and competent body for the implementation of the anti-corruption program, prevention and counteraction to corruption, and control over compliance with officials of corporate ethics.

The formation of such a body should be conducted solely on the basis of transparent public competitive selection, minimizing reputational risks and abuses.

It is important to ensure the full independence of such an institution, both during its formation and in the implementation of its work.

The creation of an independent financial security authority must meet the main criteria:

- Institutional independence
- Competence
- Presence of necessary powers

It is necessary to ensure the adequacy of the authority of such an authority, in particular in the following aspects:

- control over observance of legislation on prevention of corruption;
- Implementation and control of the anti-corruption program;
- development and control of the Code of Corporate Ethics;
- conducting official investigations and checking the performance of the officials of the management unit of Ukrainian Railways JSC, its departments, offices and affiliates.

## **Corporate ethics**

To perform effective means to counteract the abuse of officials, it is necessary to ensure the development and implementation of the Code of Corporate Ethics, the creation of transparent and public mechanisms for assessing the activities of officials of the managing body of Ukrainian Railways.

Corporate ethics should ensure a balance of interests of the company and guarantees of objectivity in the appointment and implementation of its functions by officials of the company.

The Code of Corporate Ethics should provide an effective basis for the professional selection of employees and the inevitability of punishment in case of abuse of office.

## **Open competitive selection of managers and directors of the company**

In order to increase professionalism and eliminate corruption-related risks, it is necessary to reform the personnel system, to select and evaluate the work of officials of the management unit of Ukrainian Railways JSC. To introduce transparency of information about candidates for the position and principles of their selection using the rating principles of independent evaluation. Ensure publication of information about the staff of the management, their biography, experience and compliance with the qualification and reputation criteria of the post.

Implement modern systems for assessing the effectiveness of work and reaching outcomes of senior management officials.

## **Procurement planning**

Currently, the procurement plans of JSC "Ukrzaliznytsia" and its subsidiaries are spontaneous and unorganized, they are constantly adjusted and do not perform the main function - to inform potential suppliers about the company's needs and planned procurement in advance.

It is necessary to introduce projected procurement policy, requirements for reasoned prerequisites for adjusting plans.

### **Control over procurement**

One of the problems of transparency of tenders is the lack of effective control over the activities of tender committees and the transparency of procurement.

The introduction of an independent body with enough competence and authority will allow to neutralize most of the threats of over-pricing procurement, artificially restrict competition, and impede the free access of market participants to tenders.

### **Monitoring of the supply market**

Implementation of market monitoring tools and attracting new market participants to procurement will increase the competitiveness of the tender.

It is necessary to create quality tools for monitoring the market and increase the reputation of JSC Ukrainian Rail Company as a purchasing organization.

### **Freight transportation**

It is necessary to minimize the influence of administrative and regulatory decisions of the officials of JSC "Ukrainian Railways" on the distribution and formation of freight traffic.

Introduction of efficient systems of the automated process of distribution of empty wagons in all types of transportation; modernization of work with clients of the company and simplification of ordering of services, creation of systems of tracking of movement of a load.

The company needs to introduce mechanisms for increasing the speed of the freight wagon turnover and the efficiency of transportation.

There is a need of clear long-term strategy for the introduction of bimodal and intermodal transport as a means of increasing competition in the freight transport market.

The study of the implementation of the routing of transportation of grain cargoes and export cargoes will be required.

### **Tariff policy**

The tariff formation process should meet the basic principles: validity, objectivity and transparency. The lack of a clear structure of the tariff for transportation leads to unevenness in meeting the needs of the company, imbalance in the functioning and depreciation of funds.

The development of a predicted system for calculating tariffs with economically justified items of expenditure should be based on a coherent long-term plan for the company's operation and a balance of production needs and interests of shippers.

### **Passenger transportation**

It is necessary to introduce measures to control the quality of passenger transport, increase the speed of passenger traffic, and introduce high-speed traffic.

The company needs a strategy for developing and improving the specificity of rail passenger services on the services market.

### **System of control and distribution of functions**

It is necessary to optimize the bodies and structures of the company with a clear demarcation of competences and responsibilities and a clear system of interaction between the bodies.

Simplification of duplication of functions by different bodies and the distinction of a clear vertical; Liquidation at regional branches of sectoral services that duplicate the functions of the relevant departments; Creating a system of direct interaction between departments and subdivisions - that are necessary steps to reduce the overload of company management personnel.

Distribution of the directions of the company's operation and the creation of separate branches (divisions) of competence - freight transportation, passenger transportation, suburban transportation, locomotives and

others, according to the model of the leading European railways, will allow distribution of areas of responsibility and competencies and will help to optimize the company's management system.

### **Locomotives**

There is an urgent need along with updating the fleet of locomotives to implement measures to modernize the existing fleet of railways in the future 5-8 years with the extension of the life of locomotives.

The parallel renewal of the park at the expense of the purchase of new units of locomotives and modernization of the existing park will allow us to modernize the company's locomotive base as soon as possible.

### **Implementation of employee motivation systems**

The company inefficiently uses employee incentive schemes to reduce and optimize costs. The level of remuneration does not depend on economy and saving the resources of the company. The most promising segments are the use of fuel and energy resources and materials.

In particular, the introduction of a successful system of motivating locomotive brigades to save fuel and energy resources can potentially provide a reduction of expenditures for these items by 8-10% or up to 2 billion UAH. per year.

### **Implementation of innovative solutions**

Ukrzaliznytsya has a critical level of wear and tear and moral deterioration of assets. The production, equipment, and rolling stock of the company do not meet the modern standards of rail transport, and as a result, the company cannot provide the provision of quality services.

The company has a huge potential for technological upgrading and updating, modernization and development of new technologies that can make a step for the company from the past to the future.

The development of effective scientific and technological research of new technologies can allow company to accelerate the pace of technological evolution.

The company has to revive high standards of scientific and technological research and invest in the research of the latest technologies and create a favorable climate for the work of experts and scientist.

The lack of its own intellectual potential transforms the company into a consumer of other people's ideas and leaves behind technological advances.

\* note - full information on the circumstances and business entities that are included in the analysis are available at [zbk.org.ua](http://zbk.org.ua). During the analysis, such areas as disposition of property of the company, corruption in the field, etc. are not considered in the absence of full access to the specified information.

The analysis used data: the professional bi.pro analytics module, the official answers of PJSC "Ukrainian Railways", the Register of court decisions, the registers of the National Agency for the Prevention of Corruption, the data portal.gov.ua, Dozorro.org, the official sites of the General the Prosecutor's Office of Ukraine, the National Anti-Corruption Bureau and other public resources.

