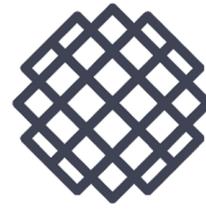




Republika e Kosovës  
Republika Kosova  
Republic of Kosovo



Zyra Kombëtare e Auditimit  
Nacionalna Kancelarija Revizije  
National Audit Office

**Document No: 20.1.6-2017-08**

**AUDIT REPORT**  
**ON FINANCIAL MANAGEMENT AND CONTROL FOR PUBLIC**  
**DEBTS COVERING THE PERIOD 2009-2017**

**Prishtina, June 2018**

The National Audit Office of the Republic of Kosovo is the highest institution of economic and financial control which, according to the Constitution and domestic laws, enjoys functional, financial and operational independence. The National Audit Office undertakes regularity and performance audits and is accountable to the Assembly of Kosovo.

Our Mission is through quality audits to strengthen accountability in public administration for an effective, efficient and economic use of national resources.

We perform audits in line with internationally recognized public sector auditing standards and good European practices.

The reports of the National Audit Office directly promote accountability of public institutions as they provide a base for holding managers' of each individual Budget Organizations to account. We are thus building confidence in the spending of public funds and playing an active role in securing taxpayers' and other stakeholders' interests in enhancing public accountability.

This audit of financial management and controls taken by the National Audit Office is independent and objective review of the management process of the Public Debts, and the appropriateness and effectiveness of the controls applied.

Regarding the need of the audit, the Auditor General has decided in consultation with the Assistant Auditor General Qerkin Morina, who supervised the audit.

The report is a result of the audit carried out by the team leader Shkëlqim Xhema, and team members Agron Fetiu and Muhamet Balaj.

## TABLE OF CONTENTS

Executive Summary .....	4
1 Audit Scope and Methodology .....	6
2 Legal Basis, Regulations and Procedures .....	7
3 Public Debts Accounting System and Reporting .....	11
4 Financial Management and Control .....	12
5 Overall Conclusions .....	23
Annex I: Progress in implementing the recommendations of the previous year .....	24
Annex II: Letter of confirmation .....	25

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## Executive Summary

### Introduction

This report summarises the key issues arising from our audit of the Public Debts from 2009 until 31<sup>st</sup> of December 2017. The review of procedures, policies, instructions and transactions of the financial management and application of internal controls was undertaken in accordance with the International Standards on Supreme Audit Institutions (ISSAIs). Our approach included such tests and procedures as we deemed necessary to arrive at a conclusion related to the quality of financial management and effectiveness of controls applied by the Ministry of Finance in the area of public debts.

Our audit focus has been on:



The level of work undertaken by the National Audit Office to complete this audit is determined by the quality of internal controls implemented by the Management of the Ministry of Finance and the Treasury.

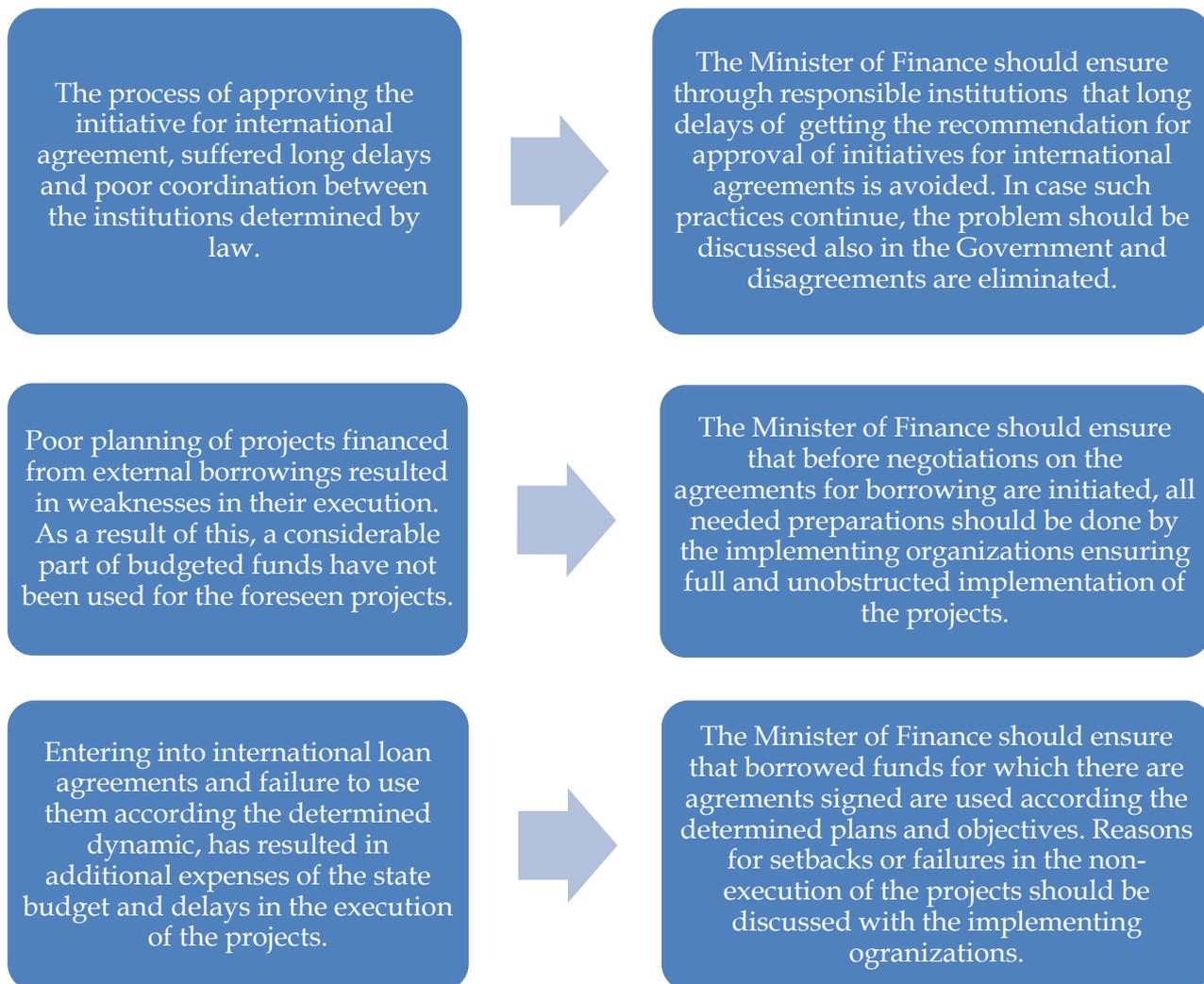
The National Audit Office highly acknowledges the Management and Staff within the Ministry of Finance for cooperation provided during the audit process.

### Key Conclusions and Recommendations

The Ministry of Finance during 2009-2017 in general adhered to the allowed legal ceiling for obtaining of public debts. The trend marked during this period does not reflect any threat for the financial stability of the country.

The Ministry of Finance has very effective controls in the identifying, processing, recording and reporting of public debts, as well as adhering to the agreements for timely return of debts in line with the timeframes of the maturity. However, the implementation of planned projects through financing from borrowings resulted in weaknesses that require further attention of the Government and the beneficiaries of these funds.

Our audit has resulted in identifying weaknesses in the processes as follows:



### **The response of the Management within the Ministry of Finance on audit of the public debts**

The Management of the Ministry of Finance has agreed with audit findings and conclusions and committed to implement all given recommendations.

# 1 Audit Scope and Methodology

## Introduction

The Audit Scope has been focused in responsibilities on financial management, related with:

- Whether the accounting and internal reporting system are sufficient and appropriate;
- Whether the account records, systems and transactions comply with applicable laws and regulations;
- Whether the internal control systems are appropriate and effective, as well as the actions of the internal audit taken in the area of the public debts.

With aim to fulfil of our responsibilities, we have undertaken the following activities:

- We have reviewed the annual financial reports of the public debts;
- We have carried out substantial comprehensive tests on the financial transactions;
- We have implemented a combination of judgement and random samples when selecting of transactions for testing;
- We have relied upon a combination of interviews, analytic reviews and the review of documents to evaluate the validity and regularity of the financial transactions; and
- We have assessed the quality of the Internal Audit work in the area of the public debts.

Audit work undertaken was relied upon the risk assessment for audit of the public debts. We have analysed the Ministry of Finance's businesses, respectively the Treasury Department to what extent the management controls can be relied upon to determine the level of the overall testing, required to provide the evidences that support our audit conclusions.

The following sections provide a more detailed summary of our audit findings, with specific emphasis on observations and recommendations in each area of review.

Our procedures included a review of the internal controls, accounting systems and related substantive tests to the extent considered necessary for the effective performance of the audit. The audit findings should not be regarded as a comprehensive statement of all the weaknesses which could exist, or of all improvements which could be made to the systems and procedures operated.

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## 2 Legal Basis, Regulations and Procedures

We have considered the legal basis, accompanying regulations and the procedures followed regarding the issuance and management of state debts, state guarantees and municipal debts.

The Law on the Public Debts no. 03/L-175, grants the Government the right to borrow money, provide guarantee for the borrower, pay the expenses for getting the debt and pay the principal and the interest of the state debts. Except this, the right and responsibility is granted to the Minister of the Finance to take care of the entire management and administration of Debts and the authorised programs for the guarantee of borrowings in the Republic of Kosovo, including ceilings, the development of a Program for the Management of Debts and the Strategy for the Management of Debts.

In order to enhance the transparency of management and determining the management responsibilities, the Ministry of Finance drafted relevant Regulations and Procedures, such as:

- Regulation GRK No. 22/2013 on Procedures for the Issuance and Management of State Debts, State Guarantees and Municipal Debts;
- Regulation MoF-CBK No. 01/2014 on Primary and Secondary Market of Securities of the Government of the Republic of Kosovo;
- The Procedure for recording of receipts and payments of the public debt in KFMIS; and
- The Procedure for recording of receipts and payments of the international state debts for the determined projects in KFMIS.

The Ministry of Finance is the only authorised entity to enter into State Debts for the following purposes:

- For financing of the State budget deficit, when authorised expenditures with law exceed or according to the evaluation of the Minister, have a possibility to exceed the required revenues to pay those;
- For financing of the investment projects which are assessed to be of national interest and are included in the Budget of Kosovo and in the Mid-Term Expenditures Framework;
- To re-fund the State Debts<sup>1</sup> contracted earlier;
- To pay the State Guarantees, fully or partially, in case if the creditors fail to meet their borrowing obligations;
- To pay the expense of the State Debt service, including but not being limited only in the related expenses, for i.e. provisions for issuance of securities, maintenance of the accounts, re-purchase and provisions of the fiscal agencies; and
- To pay related expenses related to a national emergency declared by the Assembly.

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<sup>1</sup> The Debt on behalf of Central Government Institutions which the Republic of Kosovo is obliged to pay but will not include any liability of other determined governmental entities, including but not limited in Municipalities, Publicly Owned Enterprises or the Central Bank of Kosovo.

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The Law for the Public Debts states that In no event shall the outstanding principal amount of Overall Debt exceed forty percent (40%) of the Gross Domestic Product (GDP). In the event that Overall debt<sup>2</sup> would exceed forty percent (40%) of GDP, the Government will present to the Assembly a strategy to bring Overall Debt back under the threshold of forty percent (40%) within one year.

the State Debt Management Division (DMD) has been established in the Ministry of Finance, within the Treasury. This division is responsible for the functions of state borrowing risks management, negotiation of financial terms, management of the borrowing strategy, reporting, recording and service of the state debts.

The Treasury respectively the DMD operates in coordination with the Department of the Economic and Public Policies and the Budget Department within the Ministry of Finance. When it comes to the management and administration of the State Debts within the Ministry of Finance, the negotiation issue is divided into two divisions:

- The Debt Management Division; and
- The International Financial Cooperation Division.

When it comes to the International Financial Agreements, by the end of 2016, a segregation of responsibilities has been done regarding the international financial organizations, whereby officials within these divisions will cover.

After reviewing the procedures for ratification of the international financial agreements, we have identified several weaknesses following the process, which are presented as follows:

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<sup>2</sup> The Total Debt is the sum of the state debts and municipal debt.

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**Issue 1 - Delay in approving the initiative for negotiating international agreements**

**Finding** According to the Law for international agreements, initiatives for the international agreements coming from Ministries are in principle approved by Government, following the recommendation by the Ministry of Foreign Affairs (MFA).

Regarding this, the MoF on 20.03.2014 made a request to MFA for approving the initiative for the Health Project agreement. The MFA had not given response for a long time to the MoF request, and due to these delays, the MoF proceeded further procedures without the MFA approval. We have found many correspondences written by the Ministry of Finance to the MFA for the acceleration of procedures, but in spite of this, the MFA has continued to be negligent in reviewing requests.

**Risk** The delays in obtaining consent for launching negotiations for agreements with creditors for certain projects, increases the risk of failure for planned projects to be financed by external borrowings and indicates a unserious relationship with international creditors. Continuing such practices may affect the credibility of existing partners, but also creating new arrangements with other creditors.

**Recommendation 1** The Minister of Finance should initiate a detailed review of the process in order to identify all reasons of delays and undertake measures and actions to avoid barriers that lead to delay of starting process for the initiated agreements. In case such practices continue, the problem should also be discussed in the Government and disagreements are eliminated.

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**Issue 2 - Discrepancies in the agreements text between Albanian and English language**

**Finding** Before the international agreements are ratified, as such they are prepared in English, Albanian and Serbian language.

In the financing agreement between the Republic of Kosovo and the International Development Association for the Health Reform Project<sup>3</sup> in the amount of €18,613,139, ratified by the Assembly on 26<sup>th</sup> of March 2015, within the text of English language, article II - Financing, paragraph 2.05, foresees an interest rate of 1.25%. But this article does not exist in the text of Albanian language. It is not clear how this article will be applied in case of any dispute between the parties to the agreement.

**Risk** Non-consistency or discrepancies of the text and full content of the international agreements in authorized languages, increases the risk that the Assembly of Kosovo ratifies incomplete and unclear agreements, with the possibility of interpreting issues according to the interest of the parties in agreement. This implies the need to implement the agreements even for parts that have not been approved by the Assembly.

**Recommendation 2** The Minister of Finance should strengthen administrative and translation controls and ensure that all signed and ratified agreements in the Assembly of Kosovo, have full consistency in content wise and do not contain uncertainties when interpreted in the official languages published in the Official Gazette and their implementation in practice.

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<sup>3</sup> The agreement was signed on 15<sup>th</sup> of January, 2015.

## 3 Public Debts Accounting System and Reporting

### Introduction

The Ministry of Finance through the Kosovo Financial Management Information System (KFMIS) records all financial transactions when it comes to the state debts. The public debt is managed through a database known as CS-DRMS system (Commonwealth Secretariat - Debt Recording Management System), where all international agreements and auctions of securities, all deriving data and transactions are recorded. Further on, this system has the possibility of generating different types of reports.

When it comes to Domestic Debt Management, for the instruments of securities, Central Bank of Kosovo as a fiscal agent of the Government of Kosovo, manages and administrates with the securities system.

### 3.1 Accounting System and Reporting

Regarding the account system and financial reporting of the public debts, in accordance with the laws and other legal acts, the MoF/Treasury prepares quarterly periodic reports as well as annual reports on a regular basis for the balance the public debts. The reports prepared by the accounting system match with data reported in quarterly and annual reports on public debts.

When it comes to reporting, the Ministry provides a program for the state debt on annual basis which presents the national policy for the debts that includes a debt management strategy within the sustainability framework.

The Central Bank of Kosovo keeps, records, trades and settles all transactions of the Government Securities through the accounting recording system, which includes all initial electronic purchases in the primary auction, electronic trading and recording of Securities.

For information purposes, Chief Administrative Officers (CAOs) of the implementing Budget Organisations (BOs) report to the Treasury on the level of the project execution financed from the international borrowing, not later than the fifth day of the coming month after each quarter. This is done by submitting the reporting in electronic and physical forms. Regarding this, the Treasury organizes regular periodic meetings with BOs, with purpose of monitoring the implementation of the projects. This requirement started to be applied from April 2017 with purpose of considering all challenges regarding the implementation of the projects.

## 4 Financial Management and Control

### Introduction

Our work related to Financial Management and Control (FMC), reflects the detailed audit activities for the applied systems within the Ministry of Finance on management and controls of public debts. Specifically, the focus of the audit was the purpose, respectively reasons why state enters into loan obligations, financing of public needs from these funds, achievement of government objectives, legal compliance, as well as management of these liabilities.

### Financial Management and Control Conclusion

The Overall Debts identified by the Ministry of Finance at the end of 2017 was €996,423,735. In this amount are not included state guarantees of 44 million euros. These amounts compile 16,63% of Gross Domestic Product (GDP). The Ministry of Finance has held under control the ceiling allowed under the Law on Public Debts. Further on, according to the state debt program, the percentage of the debt share in foreign currency was 14%, while the share in the interest rate of the variable interest 16% that are within the ceilings in terms of currency risk and interest rate.

Mid-term projections of borrowing rely on MTEF, however the annual borrowing plan determined with this framework was not executed according to the planning. Despite the inclusion in the Budget Law of projects financed through borrowing aiming at economic development, the controls applied in this area are insufficient to ensure that their execution is according to the planning and is bringing public benefits.

The internal controls applied by the Ministry of Finance in the area of the public debt administration are quite effective. Complete and accurate evidences are in place, and regular financial reports are published on debts situation/balance. We have not found any evidence for delays in their return according to the determined timeframes, the issue of the efficient use of these funds remains the area where particular weaknesses have been identified. This problem cannot be addressed only by the respective Ministries, but it is also needed to include the Government and the beneficiaries of these funds.

Our conclusions are that the analysis of the projects planned to be financed through borrowing are not sufficient. A number of the capital project for which the Government has entered into international loan agreements, have not been executed at all. As a result, expenses of other fees or the fees of commitments for unspent funds have started to be paid, meanwhile the Government programs are still in a low execution level.

The Internal Audit Unit of the Treasury had carried out an audit in the area of Cash and Debts management, where one of the objectives was the management of payments and data retention in the Debts Management System. Whereas, regarding the debt management and administration, the IAU did not carry out any specific audit.

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## 4.1 Financing Sources

### 4.1.1 External Financing Sources

The International Debt ratified at the end of 2017 was €1,080,470,000, while the unreturned debt or stock was €422,150,000. €784,670,000 have been withdrawn from the value of ratified loans, while the value of €295,810,000 remains unwithdrawn.

The International Debts of the Republic of Kosovo are subject to the agreements with foreign governments, government agencies, international financial organizations or other foreign organizations and companies according to the international agreements, treaties, conventions or other similar agreements which are subject to the laws of a legal jurisdiction other than that of the Republic of Kosovo.

The International Debt of Kosovo is external debt, which consists of borrowings within the programs with the International Monetary Fund (IMF), borrowings from the World Bank (WB), the German Development Bank (KfW), the European Bank for Reconstruction and Development (EBRD) and other small share creditors. Excluding the programs with the IMF, all other borrowings are related for the financing of specific projects in different sectors.

Contracting of external debt with creditors is multilateral and bilateral. The category of multilateral loans includes loans from the International Bank for Reconstruction and Development (IBRD), the International Development Agency (IDA), European Investment Bank, IMF, Islamic Development Bank and the OPEC Fund for International Development. While, the bilateral creditors include Kreditanstalt für Wiederaufbau Development Bank (KfW), Austria UniCredit Bank, Hungarian Exim Bank, the Saudi Funds for Development and French NATIXIS.

### 4.1.2 Domestic Financing Sources

For the financing of the domestic debt, the Minister is the only authorized to issue Government tradable securities, such as Treasury bonds and bills only in electronic negotiable form. The domestic debt has started from 2012 and until the end of 2017 increased into the value of €574,271,578.

The securities are issued in the Euro currency, which avoids currency risk, have low transaction costs and assist in development of local capital market. The domestic debts is issued and used for financing of the budget deficit. At the end of 2017 the share of the domestic debt in total debt is 57.6%.

In 2012, the securities were mainly with maturity of 3 and 5 months, while now in 2017, securities have been issued with maturity up to 7 years.

According to the current situation, for the primary and secondary securities market, mainly holders of securities are primary stakeholders and primary participants (commercial banks and Pensions Trust), and in lower percentage are physical and legal investors.

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## 4.2 Overall Debt

The Overall State Debt of Kosovo has been created in 2009 and at that time consisted only from the Consolidated Loan C<sup>4</sup> in the World Bank. Now, the Overall Debt consists from the international debt, domestic debt and state guarantees. The debt trend over the years appears as follows:

**Table 1. The Overall Debt** (in millions of euro)

Description	2009	2010	2011	2012	2013	2014	2015	2016	2017
International Debt	249.01	260.08	253.71	336.60	323.76	326.35	371.17	373.77	422.15
Domestic Debt	0.00	0.00	0.00	73.31	152.51	256.52	377.78	478.97	574.27
<b>Overall Debt</b>	<b>249.01</b>	<b>260.08</b>	<b>253.71</b>	<b>409.92</b>	<b>476.27</b>	<b>582.87</b>	<b>748.95</b>	<b>852.74</b>	<b>996.42</b>
State Guarantees	0.00	0.00	0.00	0.00	0.00	10.00	10.00	20.00	44.00
<b>Overall Debt + Guarantees</b>	<b>249.01</b>	<b>260.08</b>	<b>253.71</b>	<b>409.92</b>	<b>476.27</b>	<b>592.87</b>	<b>758.95</b>	<b>872.74</b>	<b>1,040.42</b>
<b>Overall Debt (% of GDP)</b>	<b>6.12</b>	<b>5.91</b>	<b>5.27</b>	<b>8.10</b>	<b>8.94</b>	<b>10.65</b>	<b>13.07</b>	<b>14.58</b>	<b>16.63</b>
GDP from KAS	4,070	4,402	4,815	5,059	5,327	5,567	5,807	5,985	6,257 <sup>5</sup>

According to the Law on Public Debts, in no event the amount of the principal unpaid of the overall debt shall exceed forty percent (40%) of the Gross Domestic Product (GDP). Regarding this, the percentage of the overall debt at the end of 2017 was 16.63% in relation to GDP. While in the state debt program, the MoF has determined the risk ceiling in order that the determined duties on the risk management and monitoring for the state debt portfolio is within the sustainable cost and tolerable risk.

**Table 2: Overall Debt according to the currency and the interest rate** (in millions of euro)

Description	2013	2014	2015	2016	2017
<b>Overall Debt</b>	<b>476.27</b>	<b>582.87</b>	<b>748.95</b>	<b>852.74</b>	<b>996.42</b>
Debt in Euro currency	402.34	506.15	650.92	758.85	856.91
Debt in SDR <sup>6</sup> currency	73.93	76.73	98.03	93.89	139.51
% of debt in Euro	84%	87%	87%	89%	86%
% of debt in SDR	16%	13%	13%	11%	14%
Debt with fixed interest	370.54	481.14	621.21	738.78	835.65
Debt with variable interest	105.73	101.73	127.74	113.96	160.77
% of fixed debt	78%	83%	83%	87%	84%
% of variable debt	22%	17%	17%	13%	16%

<sup>4</sup> The Consolidated Loan C is a loan inherited from Ex-Yugoslavia as part of the Kosovo State Debt.

<sup>5</sup> The 2017 GDP amount was taken from the Law on Budget Review 2017, as KAS does not publish this data until September 2018.

<sup>6</sup> SDR (Special Drawing Rights) is a basket of currencies which consists of the currencies in following: EUR, USD, GBP, JPY and CNY. The SDR value is determined on the basis of an average which is drawn from the value of currencies mentioned above. This basket is reviewed every five years by the IMF Executive Board.

The ceiling set for the currency risk is not more than 30% of overall debt that can be in the main foreign currencies. While for the risk of the interest rate, the ceiling set is not more than 30% of the overall debt that could have variable interest rate.

Based on this program we see that the percentage of the currency risk and the risk of interest rate are within the ceilings set. The debt percentage at the end of 2017 in foreign currency is 14%, while in the variable interest rate is 16%.

#### 4.2.1 International Debt

At the end of 2017, the International Debt was €422,150,000 or 42.4% of the overall debt, while in relation to GDP, the International Debt was 6.75%.

**Table 3: International Debt**

(in millions of euro)

Description	2009	2010	2011	2012	2013	2014	2015	2016	2017
International Debt	249.01	60.08	253.71	336.60	323.76	326.35	371.17	373.77	422.15
Central Governance	249.01	260.08	253.66	336.46	321.73	316.54	339.87	323.93	365.18
Sub-borrowing Debt <sup>7</sup>	-	-	0.05	0.14	2.03	9.81	31.30	49.83	56.97
International Debt (% of GDP)	6.12%	5.91%	5.27%	6.65%	6.08%	5.86%	6.39%	6.25%	6.75%
GDP from KAS	4,070	4,402	4,815	5,059	5,327	5,567	5,807	5,985	6,257

From the table we notice that the international debt in 2017 was increased by €48,380,000 the debt by creditors, withdrawals, funds not withdrawn, unreturned debt and the return of debt is presented in following.

**Table 4: International Debt, including the committed debt and not withdrawn**

Creditor	Ratified Debt	Debt Withdrawn	Debt not withdrawn	Debt unreturned <sup>8</sup>	The return of Debt
	(A)	(B)	(C=A-B)	(D=B-E)	(E)
IBRD	381,208,966	381,208,966	-	158,316,231	222,892,735
IAD	111,328,132	41,118,100	70,210,033	41,118,100	-
IMF	287,379,141	287,379,141	-	160,773,960	119,840,038
KfW	71,000,000	67,815,835	3,184,165	54,806,966	13,008,869
UniCredit	7,041,000	7,041,000	-	7,041,000	-
FIDO, DIB, SFD	45,617,680	102,500	45,515,180	95,901	-
EBRD	68,900,000	-	68,900,000	-	-
EIB	42,000,000	-	42,000,000	-	-
NATIXIS France	66,000,000	-	66,000,000	-	-
<b>International Debt</b>	<b>1,080,474,920</b>	<b>784,665,542</b>	<b>295,809,378</b>	<b>422,152,157</b>	<b>355,741,643</b>

<sup>7</sup> Debt that is contracted by the Government, but with a trilateral agreement has the right to sub-borrow to a public sector entity.

<sup>8</sup> The difference of the Debt unreturned changed depending on the exchange rate at the reporting date, for the loans that are in non-Euro.

From the ratified debt since 2009 until 31.12.2017 in the value 1,080 million euro, it is seen that the state has spent 785 million euro and has started to return the loans instalments in the value of 356 million euro, including also the Consolidated Loan C from Ex-Yugoslavia, as part of the State Debt of Kosovo. The biggest part of the loan return was made for the Consolidated Loan C in value of 223 million or 63% of the returned value, where the part of 123.7 million<sup>9</sup> was prepaid in 2009.

Services of the international debt from 2009 until 31.12.2017 by year, are presented in the following table:

**Table 5: Services of the international debt 2009-2017** (in millions of euro)

The Service of the International Debt	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Government</b>	<b>9.22</b>	<b>19.50</b>	<b>20.73</b>	<b>20.41</b>	<b>24.15</b>	<b>31.83</b>	<b>37.14</b>	<b>70.15</b>	<b>62.41</b>
- Return	8.48	10.68	11.99	11.34	13.99	22.05	27.54	60.55	52.39
- Interest	0.74	8.59	8.68	8.60	10.14	9.71	9.35	9.20	9.69
<b>Commitment fees</b>	-	0.11	0.06	0.00	0.01	0.01	0.06	0.18	(0.18)
<b>Other fees</b>		0.11	-	0.47	-	0.07	0.18	0.23	0.50
<b>Sub-borrowings</b>	-	<b>0.18</b>	<b>0.04</b>	<b>0.35</b>	<b>0.13</b>	<b>0.54</b>	<b>2.24</b>	<b>7.13</b>	<b>8.23</b>
- Return	-	-	-	-	-	-	1.33	5.45	6.24
- Interest	-	-	-	0.00	0.02	0.25	0.79	1.59	1.97
<b>Commitment fees</b>	-	0.01	0.04	0.10	0.12	0.14	0.13	0.07	0.02
<b>Other fees</b>	-	0.17	-	0.25	-	0.15	-	0.02	-
<b>Service of the International Debt</b>	<b>9.22</b>	<b>19.68</b>	<b>20.77</b>	<b>20.76</b>	<b>24.28</b>	<b>32.37</b>	<b>39.38</b>	<b>77.28</b>	<b>70.64</b>

The table of the international debt service presents the returns of principal, the interest expenses, commitment fees and other fees. According to the returns of loans, it is seen that the biggest returns have started from 2014, with a special emphasis in 2016 where we have the biggest return in value of €77,280,000, and in 2017 a return of €70,640,000.

After the review of procedures, from the act of entering into borrowing agreements and up to the withdraw of loans we have noticed as below:

<sup>9</sup> The part of 123.71 million has been prepaid by donors such as USA 84.12 million and European Commission 5 million, and the other part from the budget of the Republic of Kosovo 34.59 million.

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**Issue 3 – Low level of withdrawal and use of loans**

**Finding** The international debt ratified until the end of 2017 is €1,080,000,000. Withdrawn funds until the end of 2017 are €784,660,000, for which the Government has now started to return instalments according to the respective agreements, and until now the return of loan is €355,740,000.

In lack of appropriate preparations for the initiation of the projects executions, the amount unwithdrawn loans until the end of 2017 was €295,800,000. As a result of this, the Government of Kosovo is paying commitment fees for the amount of committed funds which has not withdrawn.

As a result of the inconsistency in time dynamics between the allocation of loans and the implementation of projects, the paid amount of the commitment fees for unwithdrawn funds of loans by the creditors is €890,000.

**Risk** Entering into international loan agreements and failure to withdraw funds available, is a result of poor planning and lack of government capacities to use effectively and efficiently the funds borrowed. This increases the risk of paying fees and increased loan costs, and delays in the implementation of planned projects to be financed by borrowings.

**Recommendation 3** The Minister of Finance should ensure that before actions for borrowing are undertaken, detailed analysis are carried through if there are prerequisites in place and that proper preparations for initiating the borrowing process have been made and that these funds are used in a most efficient way. Setbacks or failures to initiate or not implement projects should be subject to ongoing reviews with project implementation organizations.

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**Issue 4 – Poor management of funds for purchasing Health Equipment**

**Finding** In the financing agreement between the Republic of Kosovo and UniCredit Austria regarding the health project, respectively for purchasing of the Angiography device, the agreement was signed on 29<sup>th</sup> of October, 2015 and ratified by the Assembly on 4<sup>th</sup> of August 2016 in the amount €2,600,000.

€2,110,000 have been paid in advance in November 2016 for the purchase of Angiography device, while the equipment has not yet been brought to the University Clinical Centre of Kosovo (Cardio-Surgery Clinic). The reason for not bringing the equipment by the supplier is failure to adapt the space for putting the equipment in place according to the required standards.

Among other things, the agreement was for €490,000 higher than the purchase price of this equipment. This amount was foreseen for consultancy after the equipment is adapted. This had caused additional expenses as a management<sup>10</sup> fee of €2,450 and a commitment fee of €1,336 due to the delay in withdrawing of funds for this agreement.

Based on the analysis made by the Ministry of Health (MoH) in lack of this device that treats cardiology diseases, the MoH approximately pays €5,000,000 a year for treatment of patients in different hospitals that perform these services.

**Risk** It is unjustifiable the fact that for the equipment paid for more than a year, the spaces for their placing the equipment still have not been prepared and this indicates a poor decision-making and lack of a detailed analysis for the reason of the borrowing. The failure of the MoH to adapt the space for the Angiography Device or prolongation of project for putting this equipment into operation results in failure to provide health services for citizens and causes considerable expenses for the budget of Kosovo.

**Recommendation 4** The Minister of Finance in cooperation with the Minister of MoH should address the need to get supplied of the equipment as fast as possible and avoid all obstacles in adapting the space for putting the equipment and putting the equipment into operation according to the required technical standards.

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<sup>10</sup> The Management fee  $2,600,000 \times 0.5\% = 13,000$  euro calculate, while it should have been  $2,110,000 \times 0.5\% = 10,550$  euro. The difference of €2,450 is additional expenditure.

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## 4.2.2 Domestic Debt

The Domestic Debt has started from 2012 and until the end of 2017 has been increased to the value €574,271,578 or 9.18% of the GDP. The issued value during 2017 has served for the re-financing of instruments matured in 2017 in the value of 310 million and the new planned instruments under Budget Law 2017 in the value of €95,300,000.

**Table 6: Internal Debt** (in millions of euro)

	2012	2013	2014	2015	2016	2017
Domestic Debt (net)						
New Issuances	73.31	79.2	104.01	121.26	101.19	95.3
Debt Stock	73.31	152.51	256.52	377.78	478.97	574.27
Domestic Debt (% of the GDP)	1.45%	2.86%	4.61%	6.51%	8.00%	9.18%
GDP	5,059	5,327	5,567	5,807	5,985	6,257

In 2017, 19 instruments of securities have been issued in the value of €404,950,000. Out of these instruments, 11 were bonds in the value of 215 million with maturity from two up to seven years, and eight treasury bills in the value of €189,950,000 with maturity from 91 up to 364 days.

With purpose of extending the average maturity of domestic debt portfolio, and reduction of the new financial risk, the Treasury/MoF aims that all new issuances are made only bonds with maturity of two and more years. Regarding this, in 2017 two bonds in the value 20 million euro had seven years of maturity and three bonds with value 60 million euro had five year of maturity.

In 2017, the interest expenses for the domestic debt were €6,674,434. These expenses were for the treasury bills and bonds. The services of the internal debt from 2012 until 31.12.2017 are presented in the following table:

**Table 7: Services of the Internal Debt** (in millions of euro)

Internal Debt	2012	2013	2014	2015	2016	2017
Payment of Interest	0.66	1.19	2.5	5.50	7.91	6.67
Payments of Principal	0	0	0	0	0	0

The interest expenses for treasury bills are lower, have higher exposure to the re-financing risk due to the possibility of changing the interest rate. While, the bonds expenses are higher in relation to bills, as a result of the longer time of return. As such, the derived interest is paid based on the regulation for the Securities market, but they lower the exposure against the new financial risk due to the long-term period of the maturity.

### 4.3 State Guarantees

The State Guarantee is a potential obligation of the Republic of Kosovo which depends from the financial liabilities of another legal person and becomes part of the State Debt when the party which has the responsibility for payment of such financial liabilities, fails to carry out the payment in due time.

For the purpose of measuring the overall debt and determine the ceiling of such debt, State and Municipal Guarantees will be handled as debt. At the end of 2017 and previous years, the state guarantees were as in following:

**Table 8, State Guarantees**

**(in millions of euro)**

State Guarantees	2014	2015	2016	2017
IBRD- Guarantee for the Loan Line of DIFK	10	10	10	10
IBRD- Guarantee for Urban Traffic Prishtina	-	-	10	10
IBRD- Guarantee for the Second Loan Line for DIFK	-	-	-	24
<b>Total State Guarantees</b>	10	10	20	44
<b>Gross Domestic Product (GDP)</b>	5,567	5,807	5,985	6,257
State Guarantees (% of GDP)	0.18%	0.17%	0.17%	0.16%

The first state guarantee issued was in 2014 in the amount 10 million euro for the loan line of the Deposit Insurance Fund. The second was in 2016 in the amount 10 million euro to guarantee the Publicly Owned Enterprise Urban Traffic of Prishtina to purchase of 51 new buses.

While the issuance for the last guarantee was in 2017 in the amount 24 million euro for the second loan line of Deposit Insurance Fund of Kosovo.

## 4.4 Public Benefits from getting into Debts

Getting into debts for financing of projects from the external borrowing, indicates that there are setbacks in executing projects with public interest. The Government enters into negotiations for projects that are not ready for financing. In the table below, we have identified 10 projects for which the public benefits would be great as if they were to be implemented according to the planning and loan agreements.

**Table 9: Setbacks of the projects executions**

(in millions of euro)

No	Loaner	Loans	Ratification year	Implementing BO	The loan amount Euro	Withdrawals until 2016	Withdrawals in 2017	Un-withdrawn amount	% unexecuted
1	IDB	Financing of the Project M2 Milloseva-Mitrovica Road Improvement	2013	MoI	15.67	-	0.10	15.57	99%
2	OFID	The Extension Project of M2 Highway Milloseva-Mitrovica	2014	MoI	16.64	-	-	16.64	100%
3	SFD	The Project for the Highway Prishtina-Mitrovica	2014	MoI	13.31	-	-	13.31	100%
4	IDA	The Health Project	2015	MoH	19.60	0.09	2.11	17.40	89%
5	IDA	The Project for Energy Efficiency and Renewable Energy	2015	MED	23.87	0.94	2.75	20.18	85%
6	IDA	The Project for the Improvement of the Education System in Kosovo	2016	MEST	9.38	0.05	0.28	9.05	96%
7	IBRD	Rehabilitation of Regional Roads	2016	MoI	29.00	-	-	29.00	100%
8	BEI	Rehabilitation of Railway Line	2016	MoI, Infrakos	42.00	-	-	42.00	100%
9	IBRD	The Rehabilitation Project of the Railway 10	2016	Infrakos	39.90	-	-	39.90	100%
10	KfW	The Project for the Measures of Effective Energy in Municipalities'	2016	Municipalities (Ferizaj, Prishtina, Gjakova, Gjilan)	2.50	-	-	2.50	100%
<b>Total:</b>					<b>211.87</b>	<b>1.08</b>	<b>5.24</b>	<b>205.55</b>	<b>97%</b>

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**Issue 5 – Entering into borrowing for financing projects which were not planned well****Finding**

The Government of Kosovo on the Budget Law plans the projects it intends to implement through financing from external borrowing on a continuous basis over the years.

Within the international loan agreements, we have noticed that 10 planned projects from financing through borrowing in the amount of €211,870,000 have been ratified from 2013 to 2016, while their execution was very low, only €6,320,000 or 3% from the amount of the borrowing. Even in six capital projects in the amount €188,000,000 planned in the budget law by 2014, 2015, 2016, 2017 and two year projections, included in MTEF, their execution was only €2,630,000 or 1.6%. The non-withdrawn amount of the loans for these projects is €185,370,000. The identified setbacks are for the following projects:

- Financing of the Project M2 Millosheva-Mitrovica Road Improvement, since the ratification of three agreements for this project in 2013-2014, where project implementer was the Ministry of Infrastructure, the executed amount of the project was 0.2%;
- The Project for the Improvement of the Education System in Kosovo, 4% execution since 2016, where project implementer is the Ministry of Education, Science and Technology;
- Rehabilitation of Regional Roads, zero (0)% executions since 2016, project implementer is the Ministry of Infrastructure;
- the Project for the Rehabilitation of Railway 10, zero (0)% execution since 2016, project implementer is the Ministry of Infrastructure and Infrakos;
- Health project, 11% execution since 2015, for this project implementer was the Ministry of Health; and
- The Project for the Measures of Effective Energy in Municipalities', zero (0)% execution since 2016, implementers of the project municipalities: Ferizaj, Prishtina, Gjakova, Gjilan.

Inadequate planning of projects that would be financed by borrowing has reflected on the setbacks of their execution. The delays in the establishment of the implementer units of the projects, different procurement procedures from those foreseen by agreements of loans, etc have also affected in this low execution.

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**Risk** The Government signed and ratified international borrowing agreements for which was not prepared to implement or materialize the projects. This has affected the failure of public benefits. At the same time, the failure of projects executions from borrowing within the specified period in the agreement, increases the risk of re-negotiating the agreement and entering into new agreements.

**Recommendation 5** The Minister of Finance in cooperation with the Government and the beneficiaries of the funds, should ensure that before starting to negotiate the loan agreement for certain projects, all the conditions are met ensuring full and effective implementation of the projects. For the agreements that have not been implemented until now, analyse the causes and reasons, and appropriate actions are taken so they are implemented as soon as possible.

## 5 Overall Conclusions

Public debt, in addition to financing the budget deficit, also aims at financing investment projects considered to be of national interest in order to stimulate economic development or improve public services in different areas, but always bearing in mind that these funds should be used economically, efficiently and effectively.

Based on overall and domestic debt data, there is an increasing trend of public debt, where in 2009 the total debt was 6.12% of GDP, while in 2017 it was 16.63%. Although with the Law on Public Debt, the allowed public debt ceiling is up to 40% of GDP, the level of 16.63% of the Overall Debt stock, represents an increasing trend of percentage given the fact that €295,809,378 are assets that are not withdrawn/spent according to agreements reached with international financial institutions, even though they were available for use.

In the increasing trend of public debt, special attention should be paid to external debt, avoiding exposure to foreign exchange and variable interest rates. Delays in execution of projects, directly reflect the non-withdrawal of credit funds. As a result, for committed and unused funds, the Government is obliged to pay additional fees (commitment fee). On the other hand, the trend of increasing domestic debts, especially the increase in using bonds and the reduction of treasury bills, affects the increase in interest rates (debt cost).

The main concern in managing with these debts remain the delays in implementing/setbacks capital projects or putting them into operation in order to benefit from better quality public services and accelerated economic development.

Such delays are the result of a poor study of the project feasibility, as well as the shortcomings in putting in place the required prerequisites for eliminating all infrastructure and legal obstacles in implementing these projects, for which the Government should have an increased oversight.

## Annex I: Progress in implementing the recommendations of the previous year

Audit Component	Recommendations carried forward from 2016	Implemented during 2017	In process of implementation during 2017	Not implemented
1.1 Audit Opinion on Annual Financial Report	The Minister of Finance in coordination with the Director of the Treasury should ensure that when AFR/BRK is drafted, the explanatory notes are complete and accurate presenting detailed information for: the stock of internal and international debt, the debt situation by creditors, financial instruments.	In the Annual Financial Report, the Ministry of Finance has disclosed information regarding the internal and international debts.		

## Annex II: Letter of confirmation

REPUBLIKA E KOSOVËS/REPUBLIKA KOSOVA/REPUBLIC OF KOSOVO			
ZYRA KOMBËTARE E AUDITIMIT			
NACIONALNA KANCELARIJA REVIZIJE / NATIONAL AUDIT OFFICE			
DATE/ANULLIM/DORËZUAR: DATE/ANULLIM/DORËZUAR: DATE/ANULLIM/DORËZUAR: 28.05.2018			
Niveli Org. Org. Unit	Sht./Klasif. Classif. Kod Class. Code	Nr. Prot. Dr. Prot. Prot. No.	Nr.faqeve Dr. Stranica No. Pages
03	400	810	1



REPUBLIKA E KOSOVËS/REPUBLIKA KOSOVA/REPUBLIC OF KOSOVO			
Qeveria e Kosovës / Vlada Republike Kosovo / Government of Kosovo			
Ministria e Financave / Ministarstvo za Finansija / Ministry of Finance			
Thesari - Trezor - Treasury			
Niveli Org. Org. Unit	Nr. Prot. Dr. Prot. Prot. No.	Data Datum Date	
Thesari	85	25.05.2018	
PRISHTINEJA			

**Republika e Kosovës**  
 Republika Kosovo - Republic of Kosovo  
 Qeveria - Vlada - Government  
 Ministria e Financave - Ministarstvo za Finansija - Ministry of Finance

## LETËR E KONFIRMIMIT

Për pajtueshmërinë me të gjeturat e Auditorit të Përgjithshëm në Raportin e auditimit për menaxhimin financiar dhe kontrollet e borxheve publike për periudhën 2009-2017 dhe për zbatimin e rekomandimeve.

Për: Zyrën Kombëtare të Auditimit

Të nderuar,

Përmes kësaj shkrese, konfirmoj se:

- kam pranuar draft raportin e Zyrës Kombëtare të Auditimit për auditimin e menaxhimit financiar dhe kontrollet e borxheve publike, për periudhën 2009-2017 (në tekstin e mëtejshëm "Raporti");
- pajtohem me të gjeturat dhe rekomandimet dhe nuk kam ndonjë koment për përmbajtjen e Raportit; si dhe
- brenda 30 ditëve nga pranimi i Raportit final, do t'ju dorëzoj një plan të veprimit për zbatimin e rekomandimeve, i cili do të përfshijë afatet kohore dhe stafin përgjegjës për implementimin e tyre.

z. Bedri Hamza,  
 Ministër i Financave  
  
 Data: 24 Maj 2018, Prishtinë