

# ANNUAL AUDIT REPORT

# 2017

Prishtina, August 2018

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## Table of Content

List of Abbreviations .....	3
Foreword of the Auditor General.....	4
Introduction.....	6
Executive Summary.....	7
<b>Part I: Annual Financial Statements.....</b>	<b>9</b>
1 Audit of Annual Financial Statements 2017 .....	9
2 Analysis of State Budget .....	13
3 Analysis of explanatory notes.....	28
4 Assets.....	37
5 Accounts receivable.....	40
6 Outstanding liabilities and contingent liabilities .....	42
7 Payments according to Article 39.2 of the LPFMA.....	45
8 Employment data.....	47
<b>Part II - General .....</b>	<b>49</b>
9 Implementation of recommendations.....	49
10 Opinions on Individual Audit Reports .....	54
11 Good Governance .....	55
12 Procurement .....	59
13 Developments in public administration reform.....	65
14 Applicability of laws and legal challenges.....	67
15 Performance Audits.....	71
16 Publicly Owned Enterprises.....	78
Annex I: Explanation of the different types of opinion applied by NAO.....	87
Annex II: Progress in implementation of recommendations given in AAR 2016 .....	89
Annex III: Main financial statements of the Government.....	96

## List of Abbreviations

<b>AAR</b>	Annual Audit Report	<b>IPSASB</b>	International Public Sector Accounting Standards Board
<b>AC</b>	Audit Committee	<b>ISSAI</b>	International Standards of Supreme Audit Institutions
<b>AFR/BRK</b>	Annual Financial Report on the Budget of the Republic of Kosovo	<b>KC</b>	Kosovo Customs
<b>AFS</b>	Annual Financial Statements	<b>KFMIS</b>	Kosovo Financial Management Information System
<b>AG</b>	Auditor General	<b>LCS</b>	Law on Civil Service
<b>BO</b>	Budget Organisation	<b>LPFMA</b>	Law on Public Financial Management and Accountability
<b>BRK</b>	Budget of the Republic of Kosovo	<b>LPP</b>	Law on Public Procurement
<b>COPF</b>	Committee for Oversight of Public Finance	<b>MED</b>	Ministry of Economic Development
<b>DDG</b>	Donor Designated Grants	<b>MoF</b>	Ministry of Finance
<b>EU</b>	European Union	<b>MoH</b>	Ministry of Health
<b>FMC</b>	Financial Management and Control	<b>NAO</b>	National Audit Office
<b>GDP</b>	Gross Domestic Product	<b>PAK</b>	Privatisation Agency of Kosovo
<b>GFS</b>	Government Finance Statistics	<b>PIFC</b>	Public Internal Finance Control
<b>IA</b>	Internal Audit	<b>PHI</b>	Public Health Institutions
<b>IAU</b>	Internal Audit Unit	<b>POE</b>	Publicly Owned Enterprise
<b>IFI</b>	International Financial Institutions	<b>PRB</b>	Procurement Review Body
<b>IMF</b>	International Monetary Fund	<b>PTK</b>	Post and Telecom of Kosovo
<b>IPSAS</b>	International Public Sector Accounting Standards	<b>TAK</b>	Tax Administration of Kosovo
		<b>TSA</b>	Treasury Single Account
		<b>WB</b>	World Bank

## Foreword of the Auditor General



*Besnik Osmani*  
*Auditor General*

Honourable members of the Assembly,

I have the pleasure to submit to you the Annual Audit Report for 2017. This report is as a result of a comprehensive audit of public accounts and government balances, as well as procedures applied by the Government in implementation of 2017 budget. Annual Financial Statements of the Kosovo Budget for this period present the main basis of this report, which also includes other important information.

The primary mission of the National Audit Office is to provide reliable information to the Assembly on the use of public funds by budget spenders and other spenders, and to contribute to further improvements in the area of Public Financial Management and Control. The focus of our work is to provide reasonable assurance that public funds are planned, administered, used and reported properly. Our goal is to provide assurance to our taxpayers and donors that public resources are used economically, effectively and efficiently, and to add value to processes and the development in our country.

We have worked closely with the Assembly to expand our capacity in delivering high quality information, as well as to identify important audit topics. In this sense, it is worth mentioning the fact that the National Audit Office for the first time has issued a report on the financial management of public debts that covers the period 2009-2017. In addition, the number of Publicly Owned Enterprises audited has increased from four (4) in 2016 to nine (9) in 2017. While the quality of information in the Annual Financial Statements has constantly improved, the financial management systems and controls are in need of significant improvement.

In addition to requirements for correct reporting, what is constantly becoming more emphasised is the need for assessments: why were expenditures incurred, were funds spent for the right purposes and what are the benefits of citizens? Therefore, the need to assess performance of management systems and government programs is constantly increasing. At the same time, along the continuous increase of quality, in the last three years has also increased considerably the number of performance audits. These ever-increasing requests towards the institution of the Auditor General for a broader scope create challenges in terms of their handling at the operational, administrative and financial level. However, they also represent new opportunities for legislative and executive authorities to build a common reference framework for a better and more responsible public sector.

In our individual reports, where weaknesses have been identified, we have given constructive recommendations for improvement. We closely observe how our recommendations are addressed and we continue to work in close partnership with management bodies and responsible managers of audited entities in order to handle challenges encountered upon addressing audit recommendations. However, responses so far in this area are slow and unsatisfactory, thus the contribution of the Assembly and the Government on increase of accountability in public administration and on addressing of audit recommendations is of critical importance.

Finally, I would like to thank the Kosovo Assembly for the constant support to the National Audit Office and sound cooperation of the parliamentary committees in fulfilling our mission, as well as the staff and managers of audited entities who have worked with our auditors in fulfilling audit objectives. I hope that this report will serve as a useful tool to understand the current state of management with public finances and the financial state of Publicly Owned Enterprises.

## Introduction

This report reflects a summary of our audit work and contains the audit opinion provided by the Auditor General (in accordance with ISSAI 200) on the Financial Statements of the Government of Kosovo for 2017.

The report also highlights issues which we consider that the Government, municipalities and respective managements of other entities should actively address in order to improve management and control systems. Although in many cases the recommendations address issues that are repeated for many years in budget organisations, there are evident improvements.

For regularity audits, drafting a high quality reports is the final stage of the annual audit process. However, before that we develop a numerous audit procedures with audited entities in order to reach sustainable conclusions. Interviews with management, performance of substantive tests, and discussions on comments are just some of the actions that are undertaken during the process in order to make the audit more effective and useful for audited entities.

Using a new format of the audit report this year linking our findings in a clearer manner, their impact and recommendations, has given positive effects and was well accepted by audited institutions. In particular, almost an entirely new form of reporting has been applied within Publicly Owned Enterprises, and the reports have resulted being more complete and substantive. As a result of this, the largest part of audit, our reports have been received without any comments.

In order to enable a more effective and easier review of our audit findings and conclusions, we have structured the report into two main parts:

- a) The first part of the report is dedicated to Government's Annual Financial Statements for 2017; and
- b) The second part presents important information on the reporting year, but that does not have any direct relation and does not affect AFS of the Government.

The first part contains eight main chapters being a constituent part of the AFS of the BRK: (1) Audit Opinion; (2) Analysis of State Budget; (3) Analysis of Explanatory Notes; (4) Assets; (5) Accounts Receivable; (6) Outstanding and Contingent Liabilities; (7) Direct payments from Treasury and payments based on court decisions; and (8) Employment Data.

The second part contains information on the following issues: (1) Implementation of recommendations from previous years; (2) Opinions on individual audits; (3) Good Governance; (4) Internal Audit System; (5) Management reporting, accountability and risk management; (6) Procurement; (7) Developments in Public Administration Reform; (8) Applicability of laws and legal challenges; (9) Performance audits; and (10) Publicly Owned Enterprises.

In addition to the two main parts, the report has also three Annexes, which relate to: (1) Explanation of types of opinions applied by the NAO; (2) Progress in implementation of recommendations; and (3) Three Main Financial Statements of the Government. Individual audit reports can be found on our website: [www.zka-rks.org/en/](http://www.zka-rks.org/en/).

## Executive Summary

AFS/BRK present finances, financial transactions of budget spenders, trust funds, dedicated revenues and Government borrowings for 2017. The Ministry of Finance (MoF), on behalf of the Government prepares the AFS/BRK of the previous year, no later than 31<sup>st</sup> of March of the following year. They should be prepared in accordance with the general framework established by the Law on Public Financial Management and Accountability (LPFMA) and the International Public Sector Accounting Standards (IPSAS) for “Financial Reporting under the Cash Basis of Accounting”.

The MoF has fulfilled its obligation, by preparing and submitting the AFS/BRK for the fiscal year 2017 within the legal deadline (March 30, 2018).

Even though the AFS 2017 are complete and have disclosures of better quality than those of previous years, there is a need for improvement related to data consolidation between the FS of individual Budget Organisations and FS of the Government when it comes to reporting of non-financial assets, accounts receivable, outstanding liabilities and contingent liabilities. Many cases of non-registration of assets have been identified, incomplete presentation of assets and errors in their financial values. This comes as a result of incorrect and incomplete presentation of data in disclosures of individual Statements and their consolidation in the AFS of the Government.

Revenues are recorded properly and accurately, with the exception of some shortcomings related to timely reconciliation between Budget Organisations and the Treasury; recording of transactions in adequate economic codes; and lack of activities on collection of revenues by BOs.

Delays in initiating procurement procedures, prolonging due to complaints procedures and failures by Economic Operators to timely fulfil contractual obligations, are some of the key factors that have impact on slower levels of budget execution, especially on the budget for capital projects. This causes a high concentration of payments on the last three months, and increases the risk of ineffective controls over these payments.

In general, the Government has made good progress when it comes to improvement of Public Financial Management System. The legal framework of FMC has been updated and made clearer. However, areas that need further development are operational planning, internal management reporting, internal financial control, procurement and management of capital investments. Government needs to do more, especially in a situation when the budget is insufficient, while the needs for spending are constantly increasing. Implementation of current PIFC framework has not yet yielded the expected results, but encouraging is the fact that the PIFC Law has been recently approved.

Managerial accountability, delegation of responsibilities, and risk management are areas that require more attention. The biggest challenges in budget implementation relate to lack of managerial control in the area of planning, but also in certification of payments. There is a tremendous need to develop internal guidelines that would specify general rules, administrative instructions for specific situations and needs in each area of policies. Accountability lines between

ministries and executive agencies and handling of subsidies should be made clear in order to enhance the administrative and financial efficiency to the extent possible.

Gaps between requirements and the practice in procurement, and certification of payments should be closed as soon as possible. These shortcomings need to be taken into account in all reforms. Furthermore, appointment and extension of mandates of governing bodies should be done on time, and mechanisms that require accountability from institutions need to develop further. In many cases, the Government has not managed to select a Board of Directors that is capable of ensuring efficient practices in managing Publicly Owned Enterprises towards positive operational and financial outcomes. As a result, most of them operate with losses and have many loan liabilities. Currently, these negative results threaten the business continuity of these enterprises.

Poor management and oversight of projects, low level of budget execution, large number of payments carried out in the last quarter of the year, unclosed advances for official travel, and poor handling of revenues and accounts receivable are some of the most frequent challenges. In addition, there are many shortcomings in the area of external and internal reporting. Assets recording and better stock management continue to remain a challenge that is yet to be resolved. In order to ensure a better FMC and external reporting, new methods and tools should be considered.

Corrective steps should also be taken towards strengthening of the financial discipline, namely timely payment of liabilities owed to economic operators that provide services to Budget Organisations. A significant number of court disputes have been identified due to non-payment of liabilities, which in most cases have resulted in the favour of EOs. Subsequently, these payments based on court decisions are executed directly by the Treasury. In addition, at the request of Operators, Treasury carries out direct payments even in cases when Budget Organisations have not met their liabilities within legal deadlines (payments under Article 39.2 of the LPFMA).

A number of recommendations that systematically address the causes of these challenges have been given in this report. Recommendations have been given to the Assembly, Government and Municipal Assemblies. By addressing these recommendations, each budget spender will be in a better position to carry out its public activity in a more economical, efficient and effective manner.

By following good audit practices, we have asked the Government to introduce its comments related to the AAR. The Ministry of Finance has prepared its and Government's comments within the agreed deadlines, and after clarifying the comments, we have prepared the final version of the report. Furthermore, we have succeeded to fully agree on the manner in which the existing problems will be addressed.

## Part I: Annual Financial Statements

### 1 Audit of Annual Financial Statements 2017

The Ministry of Finance on behalf of the Government on March 22, 2018 has prepared and submitted the AFR/BRK for 2017 in the format required by the Law on Public Financial Management and Accountability (LPFMA) and according to the International Public Sector Accounting Standards (IPSAS) for “Financial Reporting under the Cash Basis of Accounting”.

AFR/BRK summarises the transactions related to all annual Government’s activities.

The General Director of the Treasury is responsible for preparation and fair presentation of AFR/BRK in accordance with IPSAS – Financial Reporting under the Modified Cash based Accounting, and is responsible for internal control which are set by the management as necessary to ensure preparation of AFR that is free from material misstatements whether due to fraud or error. This includes application of the Law No. 03/L-048 on Public Financial Management and Accountability (as amended and supplemented).

The Minister of Finance is responsible to ensure oversight of the financial reporting process of the Budget of the Republic of Kosovo.

The responsibility of the Auditor General is to express an opinion on the AFR/BRK. We have conducted the audit in line with the International Standards of Supreme Audit Institutions. These standards require us to comply with ethical requirements, plan and perform the audit in order to obtain reasonable assurance on whether the financial statements are free from material misstatements.

#### 1.1 Audit Scope and Methodology

The Ministry of Finance is responsible on behalf of the Government to prepare and present correctly the Annual Financial Statements according to International Public Sector Accounting Standards - Financial Reporting based on the Cash Basis of Accounting, and is responsible for internal controls in order to enable preparation of financial statements without material misstatements caused by errors and frauds.

The General Director of the Treasury, within the deadline and in the format required by the Law on Public Financial Management and Accountability (LPFMA) and in accordance with IPSAS has submitted the Annual Financial Statements for 2017 to the Government for approval. On March 29, 2018 the same were approved by the Government, while on March 30, 2018 a copy of the Annual Financial Report of the Budget of the Republic of Kosovo for 2017 was handed to the Auditor General.

The National Audit Office (NAO) is responsible for carrying out the regularity audit, which includes examination and assessment of Government's AFS. Our audit has focused on three main statements:

- Statement of Cash Receipts and Payments;
- Consolidated Statement of Comparison of Budget against Execution; and
- Consolidated Statement of Cash Flow, Funds Balance Sheet.

The audit objective was to provide reasonable assurance:

- Whether these financial statements present in all material aspects a true and fair view of the financial position for the audited period;
- Whether the financial statements give a true and fair view of the accounts and financial issues for the audited period; and
- Whether the Government has undertaken appropriate measures for implementation of audit recommendations for the previous and earlier years.

Examination of the AFS for 2017 was undertaken in accordance with International Public Sector Audit Standards (ISSAI). Our approach is based on a thorough understanding of the process through which the AFS have been drafted. This understanding relates to the development of an audit strategy that focuses on addressing of specific risks for an unmodified opinion, while providing an acceptable level of assurance for financial statements as a whole.

The approach taken reflects also the assessment of results deriving from audits of BOs that are consolidated into the AFS. Our procedures have included an analytical review, a review of internal controls, accounting systems, and a considerable number of tests and procedures, which were considered as necessary for an effective execution of audit.

The following sections of the report provide a more detailed summary of our audit findings, with particular emphasis of observation in each area of review. Audit findings should not be considered as a comprehensive reflection of all weaknesses that may exist, or of all improvements that may be done to government systems and procedures that have characterised 2017, but do provide an acceptable level of assurance.

## 1.2 Audit Opinion

The NAO has audited AFR/BRK for the year ended 31 December 2017, which includes Statement of Cash Receipts and Payments, Consolidated Statement of Comparison of Budget against Execution, Consolidated Statement of Cash Flow, Funds Balance Sheet, as well as the explanatory notes/disclosures of the financial statements.

In our opinion, the AFR of BRK presents a true and fair view in all material aspects for the year ended on 31st of December 2017, in accordance with IPSAS and Law no. 03/L-048 on Public Financial Management and Accountability (as amended and supplemented).

### **ISSAI 200: Unmodified Opinion with Emphasis of Matter**

#### **Basis for the opinion**

We have carried out the audit in accordance with International Standards on Supreme Audit Institutions (ISSAIs). According to these standards, our responsibilities are described in the section 'Auditor's Responsibilities for the Audit of Financial Statements'. We believe that the audit evidence we have obtained is sufficient and adequate to secure a basis for the opinion.

#### **Emphasis of Matter**

The NAO draws your attention to the fact that despite giving an unmodified opinion, Statements contain some inaccuracies and discrepancies which do not have material impact on the opinion.

In the Statement of Receipts and Payments we noticed the following differences:

- The total amount of receipts was €1,923,360,000, while €1,927,585,000 should have been presented. The difference of €4,225,000 has resulted because the amount of receipts from deposits was presented in the net amount of €2,481,000, instead of gross amount of €6,706,000. However, this does present an impact on the bank balance; and
- The total amount of payments in cash was presented in €1,836,805,000, while €1,840,921,000 should have been presented. The difference of €4,116,000 is because payments for the return of deposits were presented in the net amount of €1,014,000, instead of a gross amount of €5,131,000, but without any impact on the bank balance.

Presentation of receipts and deposits in net amounts has been practiced for many years by the MoF. As a result, these differences, in the same amounts were also presented in the Statement of Comparison of Budget against Execution.

In the Consolidated Statement of Comparison of Budget against Execution, column of Initial Budget, we have identified the following issues:

- Within cash inflow, the total of receipts should be equal to the total of payments plus the increase of bank balance by 82 million. The amount presented of cash inflow is €2,108,899,000, while cash outflow was €2,085,994,000, which presents a difference of 23 million and not 82 million; and
- Within cash outflow, donations in the amount of €12 million are not included. The total of payments according to the Initial Budget should be 2,097,994,000 and not €2,085,994,000.

Inadequate classification of expenditures is a phenomenon that is being repeated for many years, and the situation in this area has not improved. As a result of this:

- Expenditures for goods and services, and subsidies and transfers in the amount of €16,037,978 were misclassified as capital investments. Out of these €14,501,020<sup>1</sup> are due to incorrect budgeting of expenditures by the Ministry of Finance and €1,536,9582 are misclassified by EOs as a result of errors and incorrect application of accounting plan (purchase of books, road maintenance, maintenance and servicing of medical equipment, maintenance of green spaces, all of which were paid out of the category of capital investments).

### Other issues

Upon planning of the annual budget, namely, the drafting of Table 1, the Ministry of Finance does not provide a clear and consistent methodology for presentation of total Receipts and Expenditures, budget deficit and fiscal deficit. Table 1 of the initial budget that presents main information on budget parameters is not clear or consistent with Table 1 of the budget review for 2017. This table, with the budget review is presented in a completely different structure from the Table of the initial budget. The table is disorienting and the figures in the table do not preserve the historical character of the data, while comparisons are quite difficult. As a consequence of this, with the transfer of data from this Table (as a constituent part of the Law), to the Statement of Comparison of Budget against Execution, the changes between the receipts planned and payments do not present the increase of bank balance, as foreseen under the respective reporting standard.

<sup>1</sup> MIA, MI, KHUCS, Municipality of Prishtina, Suhareka, and Fushe Kosova

<sup>2</sup> Municipality of Prishtina, Suhareka, and Fushe Kosova

## 2 Analysis of State Budget

The Consolidated Financial Statements of the Government provide information on initial and final budget projections of 2017, including funds and sources of funds, as well as spending of funds by economic categories. In summary, statements present budgetary and financial performance of the Government, and the level of achievement of annual objectives.

In general, Revenues and Expenditures have marked an improving trend compared to previous years. Budgeted revenues were collected at 98%, while expenditures were incurred at 95% of funds available. The phenomenon of increased expenditures at the end of the year has continued this year as well, which in particular is a poor indicator of planning and controls over the budgets of capital projects.

The following analysis provides more thorough information.

### 2.1 Analysis of overall budget revenues and expenditures

State revenues and expenditures should be balanced, otherwise budget deficits or surpluses occur. The data presented in AFS/BRK are a reflection of real receipts and payments and respective budget appropriations. The budget of the Republic of Kosovo for 2017 was subject to budget review, where there were cuts of revenues and expenditures, which imply budget changes within economic categories in Budget Organisations.

The following table presents the trend of revenues according to initial and final projections, and the actual amount of receipts and payments. The data was taken from the current Statement of Comparison of Budget against Execution according to the MoF.

**Table 1 - Statement of Cash Receipts and Payments** (in '000 euro)

Description	Initial budget	Final budget	Outturn 2017	Outturn 2016	Outturn 2015
Receipts	2,108,899	1,968,139	1,923,360 <sup>3</sup>	1,777,908	1,707,374
Payments	2,085,994	1,941,511	1,836,805	1,763,242	1,614,338

<sup>3</sup> In this amount are not included payments from third parties.

In addition to issues described in the basis for audit opinion, main issues arising from our analysis are as follows:

- a) Differences between the Initial and Final Budget are noticed in terms of revenue planning and expenditures. Receipts were planned for €140,760,000 or 7.1% higher than those with the final budget, while payments for €144,483,000 or 7.5%. Variances between the initial and final budget projections are quite significant, and this is due to poor analysis by Budget Organisations, which should have been completed before the approval of budget.
- b) Revenues projected with the final budget were collected in the amount of €1,923,360,000, or 98% of the final budget, while expenditures were incurred in the total amount of €1,836,805,000 or 95%.
- c) Receipts during 2017, compared to those of the previous year had increased by €145,452,000 or 8%, while expenditures by €73,563,000 or 4%.
- d) Differences between the total of Receipts and total of Expenditures are €86,555,000. This amount presents unspent funds and reflects an increase of cash in the bank account of the Budget of the Republic of Kosovo, which on 31<sup>st</sup> of December 2017 has a final balance of €357,760,000.
- e) The initial budget of financing from borrowing, with the review, was reduced by €140,000,000 or 38% (from €361,000,000 to €221,000,000). Reductions have occurred within the investment clause in the amount of €105,000,000, borrowing from IMF €15,000,000, sub-borrowings €5,000,000 and IFI Project loan €15,000,000.
- f) One-off funding of the Privatisation Agency of Kosovo (PAK) as part of the table for domestic financing, according to the law of initial budget was €87,000,000<sup>4</sup>. Due to the non-approval of the PAK law by the Government, collection of these funds had not taken place, and with the budget review, one-off funding of the PAK was removed. Consequently, there have been budget cuts also in Capital Investments.

Observing the trend of the last three years, we notice that revenues and expenditures have had a systematic increase. Current revenues compared to 2016 have increased by 8%, while 12.7% compared to 2015. In addition, an upward trend is also noticed at Expenditures or payments. Expenditures, compared with the prior year are higher by 4%, while compared to those of 2015 they have increased by 13.8%.

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<sup>4</sup> Projects foreseen to be financed with one-off funding of PAK are: Motorway Project Prishtina - Hani i Elezit in the amount of €77,600,000, Sports Infrastructure €5,000,000, investment in the area of telecommunication €2,000,000, Energy Efficiency Project €1,000,000 and Subsidies to RTK in the amount of €1,400,000.

### 2.1.1 Analysis of revenues per economic category

From the analysis of revenues by source, we noticed that the main sources for financing of the budget are taxes (direct and indirect) and non-tax revenues. The table below provides more information on the final budget and budgetary trends over the last three years.

**Table 2 - Statement of budget and receipts according to sources**

Receipts	Final budget	Outturn 2017	Outturn 2016	Outturn 2015
Direct taxes	251,133,000	238,034,000	232,121,000	197,720,000
Indirect taxes	1,291,706,000	1,315,236,000	1,227,392,000	1,103,476,000
Tax returns	(44,000,000)	(57,583,000)	(38,381,000)	(35,644,000)
Non-tax revenues	201,300,000	185,881,000	175,343,000	191,267,000
Foreign and domestic borrowing	221,000,000	211,934,000	154,412,000	166,719,000
Designated Donor Grants	11,700,000	8,312,000	8,735,000	13,310,000
Other receipts <sup>5</sup>	35,300,000	21,547,000	18,286,000	70,526,000
<b>Total:</b>	<b>1,968,139,000</b>	<b>1,923,360,000</b>	<b>1,777,908,000</b>	<b>1,707,374,000</b>

#### Direct taxes

Direct taxes include three main categories: Corporate Income Tax, Personal Income Tax, Property Tax, and some other taxes in small amounts. Collection of direct taxes was at 95% of the amount planned. The main source of these taxes is Personal Income Tax with €136,924,000 (58%), Corporate Income Tax with €75,277,000 (32%), Property Tax with €22,407,000 (9%) and other taxes with €3,426,000 or around 1%. From these, the Tax Administration of Kosovo (TAK) collected Personal Income Tax and Corporate Income Tax, while Property Tax was collected by Municipalities. Compared to the previous year, direct taxes in general have marked an increase by 2.5% and 19% compared to 2015.

<sup>5</sup> In this amount are included: Deposits Fund (2,481,000), return of loans by Publicly Owned Enterprises (9,350,000), Dedicated Revenues (9,390,000) and one-off financing of PAK (326,000).

## Indirect taxes

Three dominant categories of these taxes are: Value Added Tax, Import Duty and Excises. The total of collection was exceeded by 2% compared to the amount planned under the annual budget. The Value Added Tax collected was €756,117,000 (57%), Excise tax €432,279,000 or 33%, and the remainder belongs to the customs tax in the amount of €125,993,000 or around 10%.

## Tax returns

The level of tax returns by the end of the year was €57,583,000 or 3.7 % of the total taxes collected. From these, the value of tax returns from the TAK was €48,439,000<sup>6</sup>, while returns from the Customs were €9,144,096<sup>7</sup>. Compared to the level of collections of 2016, indirect taxes collected are higher by 3%, while compared to 2015 the increase is around 19%.

The returned amount of direct and indirect taxes relates to return of internal VAT €45,142,000, return of border VAT €1,028,000, return of corporate tax €2,220,000, return of excise €7,591,000 and other types of taxes €1,602,000.

Tax returns occur due to inadequate tax charges, and differences are calculated upon reconciliation of taxes with TAK and Customs, and as such are returned to different entities. Planning of tax returns with the final budget was not even nearly realistic to the current state of returns. The value of returns from reimbursements of fiscal coupons was not budgeted in the planning of returns.

The amount of returns by €44,000,000<sup>8</sup> was estimated with the budget, while the amounts returned by the end of the year were higher by €13,583,000 or 31% than planned. Compared to 2016, tax returns were €19,202,000 or 50% higher.

The fact that taxes collected during 2017 have increased compared to 2016 by €43,757,000 or 3% remains unclear, while the increase of tax returns was €19,202,000 or 50%.

## Budget Performance of Customs and Tax Administration of Kosovo

Kosovo Customs is responsible for collection of indirect tax revenues, such as: customs duties, excise, VAT and other, while the TAK is responsible for collection of revenues from corporate income tax, personal income tax, VAT, and other.

Planned revenues of the KC for 2017 were €1,108,450,000 while collected revenues were €1,121,097,109, which shows that the plan was exceeded by €12,647,109. Even though the revenue collection plan was exceeded, the revenue management process at Customs in some cases was accompanied by shortcomings such as: deficiencies in calculation of customs base, failure to apply uniform prices when re-evaluating goods for tax purposes, and application of assessment methods in disagreement with requirements of customs code.

<sup>6</sup> Out of which €45,142,000 represent the largest share of tax returns with the return of internal VAT, and other returns in the amount of €3,297,000.

<sup>7</sup> Out of which €7,590,977 are from the return of the domestic excise and other €1,553,119

<sup>8</sup> According to the Budget Law, the value of returns was €44,000,000 but in the plan was not included the reimbursement from fiscal coupons, the value of funds returned to citizens in 2017 was €13,000,000.

Planned revenues for 2017 by the TAK were in the amount of €423,000,000, while were collected €414,354,671 or 98% of the plan.

Despite the high level of implementation of the revenue collection plan, the process of collection and management of revenues in the TAK in some cases was accompanied by shortcomings such as: non-reconciliation of revenues according to legal requirements, shortcomings in the process of fiscalization and delays in reviewing returns (reimbursements).

### **Non-tax revenues**

All types of administrative fees and other taxes, all types of fines, revenues from inspection, use of public property, tariffs of services, licenses, rents for public properties, concessionary fees, mining rent, etc., are part of non-tax revenues group.

These revenues are also collected by the central and local government entities. The total amount of non-tax revenues collected during 2017 was €185,881,000, out of which the amount of €103,445,000 is collected by Central Government entities, the amount of €43,348,000 was collected from Local Governments, and the amount of €30,570,000 was collected from Royalties and €8,519,000 from Concessionary Fees.

The budget plan for non-tax revenues was implemented only at 92%. Non-implementation of the revenue plan was affected by local Budget Organisations, where 15 municipalities had fulfilled 70% of the plan, while the Government had not collected planned revenues from the PTK dividend in the amount of €5,000,000.

Compared to the trend of the last three years, we noticed that non-tax revenues have increased by 6% compared to 2016, but are only 1% lower than those of 2015.

### **Non-disclosure of non-tax revenues for central Budget Organisations**

Within the Budget Law No. 05-L-125 on the Budget of the Republic of Kosovo for 2017, Non-tax revenues, taxes, charges and others, the amount of €100,000,000 by Central Government BOs was presented. However, there are no disclosures of amounts for each BO based on which the budget is planned.

So far, planning of these revenues has been done based on historical data and expectations in total amounts, but not in detailed plans based on individual Budget Organisations. Due to lack of a detailed plan on collection of revenues, Budget Organisations encounter difficulties in process of measuring performance with planning, and due to lack of planned data, they have presented incorrect and incomplete data on individual AFS.

### **Taxes, charges and others at the level of local government Budget Organisations**

Budget plan for non-tax revenues at the local level was €54,000,000, while collection was €43,348,000 or 80%. The level of budget execution in 15 municipalities was below 70%, while the

municipalities with poorest performance were: Municipality of Leposavic 0.3%, Zubin Potok 2%, Zvecan 9%, Decan 38%, Mamusha 40%, Dragash 48% and Malisheva 52%.

The most challenging issues in this area are: deficiencies in the revenue planning process, reconciliation process with the Treasury, delays in recording revenues in the system, recording in incorrect economic codes, and in 24 cases was reported that Municipalities have not managed to verify 1/3 of properties for property tax purposes, while the process of leasing public property was accompanied with legal shortcomings.

### **Foreign and domestic borrowing**

As a source for financing of budget needs, the Government has also taken foreign and domestic funds. The amount of borrowing during 2017 was €211,934,000, out of which €116,633,000 were foreign borrowings and €95,301,000 domestic borrowing. The purpose of borrowing is to cover budget deficits and finance capital projects.

According to the final budget, the planned amount of borrowings was €221,000,000, while €211,934,000 or 96% were borrowed. Compared to two previous years, the borrowing has increased by 37% compared to 2016, and 27% compared to 2015.

In the following sections of the report, this part will be more thoroughly elaborated.

### **Donor Designated Grants**

Donor Designated Grants are funds that should be used in accordance with the terms of agreements between the Government and Donors. These funds are planned with annual budget and are part of the overall budget revenues for financing various projects. Payments from third parties are not included in this category.

The amount of grants under the final budget was €11,700,000, while €8,312,000 or 71% were spent. Approximately a same amount (€8,735,000) was spent in 2016, while in 2015 the amount of grants spent was €13,310,000 or 60% more than in 2017. Failure to use these funds in time and efficiently poses a risk as grants may be reduced in the future.

### **Other Receipts**

The amount of receipts of €21,547,000 consists of: PAK revenues (€6,112,000), Air Navigation Service revenues (€3,279,000), return of loan by KEK (€9,350,000), various deposits Fund (€2,481,000), and one-off financing of PAK (€326 000).

## 2.1.2 Collection of budget revenues – structure of revenues

### Direct and indirect tax revenues

Direct and indirect tax revenues have a critical importance for the state portfolio and account for over 80% of the overall budget revenues. These tax revenues are generated through Kosovo Customs (KC) and Tax Administration of Kosovo (TAK). In 2017, these two agencies had delivered good performance in terms of meeting the revenues collection plan.

Planned revenues from direct and indirect taxes in 2017 were €1,542,839,000, while €1,553,270,000 were collected, whereby the plan was exceeded by €10,431,000. This result was affected by increased spending and public consumption, increased imports in support to increased economic activity in the country, but also as a result of a better customs monitoring, impact of new measures on improvement of the doing business environment, import facilitations for the production sector, plans to narrow the tax gap and informal economy, measures to promote the efficiency of collecting revenues by collecting agencies by simplifying taxation and customs system. These have contributed to increased level of revenues over the actual projections.

The fact that the revenue collection plan was exceeded is an indicator that we are dealing with a reliable and realistic medium-term projection of budget revenues, and increased caution so that the revenue planning is at an acceptable level and in line with best practices.

### Non-tax revenues

Non-tax revenues are collected by central and local government entities. The total amount of Non-tax revenues collected during 2017 was €185,881,000, out of which €103,445,000 was collected by Central Government entities; €43,348,000 from Local Government; €30,570,000 from royalties; and €8,519,000 from concessionary fees.

## 2.1.3 Analysis of expenditures per economic categories

The total of expenditures for 2017 planned according to the final budget was €1,941,511,000, while €1,836,805,000 or 94.6% of the planned amount were incurred. The percentage of expenditures was the same with the one of last year, but in nominal value, the expenditures of 2017 are by €73,000,000 higher than in 2016, and €222,000,000 higher than in 2015.

According to the Budget Law no. 05/L-125 on the Budget of the Republic of Kosovo, expenditures planned were in the amount of €2,001,000,000, while with the review of the budget law expenditures were reduced by €191,000,000. This reduction occurred due to:

- Failure to collect one-off revenues by the PAK in the amount of €87,000,000 as a result of non-approval of the Law on PAK; and
- Decrease of receipts from borrowings in the amount of €140,000,000 due to poor performance in managing projects management financed through borrowing. This was because were not withdrawn funds foreseen under relevant agreements by budget organisations implementing projects.

Budget movements in economic categories between the budget law and the reviewed budget are reflected as follows:

- Expenditures for wages and salaries from €572,000,000 with budget review have been reduced to €566,000,000, or by €6,000,000;
- Expenditures for goods and services including utilities from €225,000,000, with budget review have increased to €245,000,000, or by €20,000,000;
- Expenditures for subsidies and transfers from €473,000,000, with budget review have increased to €495,000,000, or by €22,000,000;
- Expenditures for capital investments from €722,000,000, with budget review have been reduced to €501,000,000, or by €221,000,000; and
- Financing of reserves from €9,000,000 with budget review have been reduced to €3,000,000, or by €6,000,000.

The following table presents the trend of expenditures in the last three years per economic categories.

**Table 3 – Statement of budget and expenditures per category**

Expenditures	Final budget	Outturn 2017	Outturn 2016	Outturn 2015
Wages and Salaries	559,115,000	550,749,000	544,831,000	526,311,000
Goods and Services	231,259,000	204,161,000	183,050,000	185,921,000
Utilities	27,033,000	24,158,000	23,362,000	24,166,000
Subsidies and Transfers	514,446,000	508,316,000	475,103,000	422,099,000
Capital Investments	524,609,000	471,098,000	449,147,000	406,832,000
Other payments <sup>9</sup>	85,049,000	78,322,000	87,751,000	49,008,000
<b>Total:</b>	<b>1,941,511,000</b>	<b>1,836,804,000</b>	<b>1,763,242,000</b>	<b>1,614,337,000</b>

Different from previous years, the level of budget execution at Capital investments has marked a significant increase, out of 86% in 2016 to 90% in 2017. Even in other categories there were budget surpluses, which for various reasons were not used by Budget Organisations. For example, 27 million were not spent within Goods and Services, over 8 million within Wages and Salaries, over 6 million within Subsidies and Transfers, etc. Compared to the previous year, the budget was spent in the same nominal percentage (94.6%).

<sup>9</sup> This amount includes return of debts (77,308,000), Returns from Funds of Deposit (1,014,000), Membership Fees in IFI, Reserves (74,804), and some other small payments.

The analysis of budget expenditures by categories has resulted with the following data:

**Expenditures for Wages and Salaries** – in the structure of total budget expenditures comprise 30%, which represents the category with the highest percentage of expenditures. The fund of gross salaries has increased by approximately 6 million, or 1% compared to 2016. This increase is mainly due to the increase in the number of employees in the public sector during 2017.

**Goods and Services** - Over 204 million, or 11% of the total budget were spent for supplies of goods and services. The increase of expenditures in this category compared to the last year was by more than 24 million, or over 13%. This increase was due to increased demands to increase funds for maintenance of capital projects.

**Subsidies and Transfers** - In the total of expenditures they participate by around 28%. In the last three years, there has been a rapid increase of these expenditures. Compared to 2016, the increase is by 33 million or 7%, while compared to 2015 subsidies have increased by 86 million or 20%.

**Capital Investments** - Present the total amount of budgetary funds for financing of infrastructure projects in the area of education, health and other public services. In the overall expenditures of state budget for 2017, capital investments participate with 25.6%. From the percentage perspective, it is the same level of expenditures as in 2016. The final budget for this category was €524,609,000, while current expenditures are €471,098,000 or 90% of the final budget. Compared to the previous year, there is an improvement in performance of expenditures, which in 2016 was at 86%.

Taking into account prolonged procurement procedures and complaints of Economic Operators to the PRB and other bodies, it turns out that the efficiency of spending of funds in this category has reached an enviable figure, even a record compared to the previous years.

## 2.1.4 Incurring of budget expenditures – structure of expenditures

### Wages and Salaries

The budget for 2017 was €559,115,000 while expenditures were €550,749,000 or 99% of the budget. Compared to 2016, expenditures for wages and salaries have increased by €5,918,000, or 1%. This increase was due to the increase of the number of employees by 323 in 2017 compared to 2016, as well as the calculation of work experience for employees in the public sector.

Expenditures for wages and salaries from own source revenues for both levels of government were €4,723,189 or 57% of the total €8,289,976. Municipalities that had not spent funds for salaries from OSR were: Gjilan, Kacanik, Kamenica and Junik, while from the central government the Kosovo Judicial Council had spent 10%, Ministry of Justice 23%, and the Ministry of Culture, Youth and Sports 35%.

## Goods and Services

The budget for 2017 was €231,258,730, while expenditures €204,161,930 or 88%, which compared to 2016 are higher by €21,111,000 or 11.5%. A more significant increase of expenditures was in other contracted services by €8,559,000 or 29%, medical supplies €4,745,000 or 18%, office supplies €1,745,000 or 25%, fuel for vehicles €1,831,000 or 27%, travel expenses abroad €1,147,000 or 32%, and increases in other categories in the amount of €3,084,000.

## Subsidies and Transfers

For 2017, the budget was €514,446,122 while expenditures €508,316,446 or 99% of the budget. Compared to 2016, expenditures are higher by €33,213,446 or 7%. This increase of expenditures compared to 2016 comes as a result of the increase of subsidies for public entities, pensions for war veterans, and contribution-based pensions.

## Capital Investments

The budget for 2017 was €524,609,089 while expenditures were €471,478,195 or 90% of the budget, which compared to 2016 expenditures are higher by €21,951,000 or 5%. This increase of expenditures has occurred due to construction of motorways, local roads, educational facilities, sports facilities, cultural facilities and purchase of other equipment.

Systematic shortcomings identified in individual audit reports of BOs related to Capital Investments are:

- Low level of budget execution in some Budget Organisations;
- The budget dedicated for this category was used to pay for expenditures which do not relate to capital investments, but other economic categories (wages and salaries, goods and services, subsidies);
- Weaknesses in planning of needs/projects by requesting units;
- Irregularities upon development of procurement activities;
- Delays in commitment of funds to initiate procurement processes and in recording transactions in the KFMIS in a timely manner;
- Entry into contractual obligations without securing investment funds;
- Poor management of contracts and delays in implementation of projects;
- Delays in carrying out payments and payments through enforcement procedures, courts and Treasury; and
- Certification of payments for uncompleted works and supplies that were not received.

## 2.2 Statement of Cash Flow, Funds Balance Sheet

The balance sheet of cash at the end of the year includes unspent funds from: Donor Designated Grants, Own Source Revenues of Municipalities and of other BOs that were not used during 2017, and carried forward in 2018, Development Trust Funds, Dedicated Revenues and other revenues in trust (mainly different types of deposits), and Undistributed Funds.

The Government manages funds by using the Treasury Single Account (TSA). Majority of accounts are held at the Central Bank of Kosovo (CBK). The total amount of cash in the budget account of the Republic of Kosovo on December 31, 2017 was €357,760,000.

Below is presented the data in detail.

**Table 4 - Statement of Cash Flow, Funds Balance Sheet**

Bank accounts of state budget	Year 2017	Year 2016	Year 2015
Central Bank of Kosovo	339,906,000	257,393,000	248,780,000
Development Trust Fund	5,047,000	4,125,000	3,962,000
Cash in transit	10,179,000	7,371,000	2,177,000
Money into accounts of Diplomatic Missions	1,045,000	929,000	535,000
Cash (cashbox)	1,583,000	1,385,000	1,084,000
<b>Total:</b>	<b>357,760,000</b>	<b>271,203,000</b>	<b>256,538,000</b>
Balance sheet	Year 2017	Year 2016	Year 2015
<b>A. Total of designated funds</b>	<b>65,563,000</b>	<b>58,444,000</b>	<b>54,052,000</b>
Donor Designated Grants	6,837,000	7,280,000	10,160,000
Own Source Revenues carried forward to 2018	32,880,000	27,156,000	21,787,000
Development Trust Fund	10,321,000	10,058,000	8,541,000
Dedicated revenues	803,000	841,000	856,000
Other revenues	14,722,000	13,109,000	12,708,000
<b>B. Undistributed funds</b>	<b>292,196,000</b>	<b>212,759,000</b>	<b>202,487,000</b>
<b>Total of funds (A+B)</b>	<b>357,760,000</b>	<b>271,203,000</b>	<b>256,538,000</b>

The balance of current accounts held at CBK has increased significantly compared to two previous years. Cash at the end of 2017 has increased by €86,555.00 compared to the balance sheet of 2016. This increase is as a result of increase of funds from domestic borrowings.

From the table we notice that carrying forward of unspent own source revenues is increasing, and funds carried forward from 2017 are higher by 21% compared to the amounts carried forward from 2016, and 51% higher than those of 2015. In order to have as much funds as possible for the future, budget organisations always use the General Government Grant as the primary source of expenditure.

Upon analytical reviews of the Financial Statements, we have not found any discrepancies between the data presented in the Statement above and the data in the Treasury General Ledger and Bank Accounts. Around 95% of cash is located in the Main Account of the Budget of the Republic of Kosovo in the Central Bank of Kosovo.

### 2.2.1 Cash and cash in transit

Cash in transit is cash that has been received through commercial banks as revenues of 2017, but which on 31.12.2017 have not been transferred to the Treasury account at CBK. The amount of cash in transit at the end of the year is €10,179,000<sup>10</sup>, which compared to 2016 has increased by €2,808,000.

Accounts of diplomatic missions are accounts opened in commercial banks in countries where the Government of the Republic of Kosovo has diplomatic missions and are held for the purpose of providing banking services to Embassies and Consulates in these countries. The amount of funds into these accounts for 2017 was €1,045,000. Compared to 2016, we have an increase of €116,000 or 12%.

Cash in cashbox, is the amount of petty cash held by budget organisations which have not been spent or deposited into the main account of CBK until 31.12.2017. Compared to 2016, we have an increase by €198,000 or 14%.

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<sup>10</sup> Out of the amount of cash in transit the amount of €10,179,000 are generated revenues which at the end of the year have remained into the accounts of commercial banks, on behalf of Customs and Tax Administration of Kosovo in the amount of €8,810,245, while the amount of €1,368,755 from other institutions.

## 2.3 Statement on the budget deficit ceiling

Article 22.A.1 of the Law no. 03/L-048 on Public Financial Management and Accountability (LPFMA), as amended and supplemented stipulates, “No law on budget appropriations shall include an overall deficit exceeding the estimated 2% of the Gross Domestic Product (GDP)”.

We have reviewed processes of MoF in implementation of requirements of this law regarding the budget deficit ceiling so that we are able to give a statement related to the compliance with deficit ceiling, conditions and legal requirements. Our assessment has highlighted that controls during budget preparation for 2017 regarding deficit calculations were applied within the defined framework.

Law no. 05/L-125 on the Budget of the Republic of Kosovo for 2017 was approved by the Assembly of the Republic of Kosovo with a budget deficit of 1.5% of GDP, while the current deficit at the end of 2017 was 0.8%. The GDP estimated under budget projections for 2017 was €6,410,000,000, with the budget review €6,380,000,000, and according to the final budget was €6,257,000,000.

Article 7 of Law no. 05/L-063 on amending and supplementing the Law on Public Financial Management and Accountability (LPFMA) no. 03/L-048 stipulates that: “For the purposes of compliance with the deficit ceiling from paragraph 1 of this Article, expenditures for capital projects financed externally from Supranational Financial Institutions, the European Union or its institutions, or foreign governments or their development agencies shall not be taken into account.” Thus, in the total of expenditures excluded from the fiscal rule are included expenditures of carried forward Own Source Revenues, in the amount of €17,534,000, expenditures of the Privatisation Agency of Kosovo and Air Navigation Agency of €9,428,000, return of Government loans given earlier of €9,350,000 and payments from external donors of €8,655,000.

Financing budget deficits, according to fiscal rules, is done from borrowed funds. The Government has adhered to abovementioned requirements and for the same purposes has borrowed domestically €95,301,000 or 1.5% of the projected GDP. This amount was planned to cover expenditures that were higher than planned revenues. Current deficit amount at the end of the year was €48,657,000 or approximately 0.8% of GDP.

Our conclusion is that the Government has fully implemented legal requirements related to the budget deficit, and has been very cautious in budget planning, as far as this component is concerned.

The budget deficit ceiling compared to 2016, in nominal value but also in percentage it was almost the same. The deficit according to the initial budget was 1.6%, while the current one at the end of 2016 was 0.9%. Regarding the disclosure of data in the budget deficit table for 2017, we have not identified any discrepancies in presentation of Revenues or Expenditures.

## Budget deficit analysis

The budget deficit presents differences between Revenues and Expenditures, namely, the amount of expenditures that exceeds the amount of total budget revenues. The initial budget was foreseen with a deficit of €96,468,000 (1.5%), after budget reviews was adjusted to €95,553,000, while the final budget resulted with €48,657,000 or 0.8% of GDP.

**Table 5 – Calculation of initial and final deficit for 2017**

Ordinal No	Budget Revenues/Expenditures	Planned deficit	Current deficit
<b>A</b>	<b>Receipts/important revenue (1 to 4)</b>	<b>1.700,248,000</b>	<b>1.681,568,000</b>
1.	Direct taxes	251,128,000	238,034,000
2.	Indirect taxes	1.292,145,000	1.315,236,000
3.	Tax returns	(44,325,000)	(57,583,000)
4.	Non-tax revenues	201,300,000	185,881,000
<b>B</b>	<b>Overall payments/expenditures (5 to 17)</b>	<b>1.797,638,000</b>	<b>1.730,226,000</b>
5.	Salaries expenditures	572,000,000	550,749,000
6.	Expenditures for goods and services	198,000,000	204,161,000
7.	Utilities	26,698,000	24,159,000
8.	Expenditures of Subsidies/Transfers	473,000,000	508,316,000
9.	Expenditures capital investments	726,000,000	471,098,000
10.	Reserves	4,940,000	0,00
11.	Interest expenditures	23,000,000	16,710,000
12.	Return of loan by KEK	(11,000,000)	(9,350,000) <sup>11</sup>
13.	Payments from OSR carried forward from 2016	0,000	(17,534,000)
14.	Payments from external donations	(12,000,000)	(8,655,000)
15.	Expenditures of PAK and Air Navigation	(11,000,000)	(9,428,000)
16.	Clause of investments	(105,000,000)	0,00
17.	One-off revenue of PAK	(87,000,000)	0,00
<b>C</b>	<b>Deficit (A minus B)</b>	<b>(97,390,000)</b>	<b>(48,657,000)</b>

<sup>11</sup> Amounts in brackets from ordinal numbers 10 to 13 represent negative values or amounts that reduce the total value of expenditures.

From calculation of revenues are excluded the following receipts:

- 1) Dedicated revenues of PAK and Air Navigation (€9,428,000) as these revenues according to the respective law are generated as a result of sale of public assets, which means that they do not present an increase in net value but a change in form of assets (from fixed to liquid);
- 2) Donor designed grants, as receipts are recorded in general accounts of the Government for statistical purposes but do not increase the net value of public assets (different from direct budgetary grants that finance budget expenditures). Expenditures of these grants are designated by donors, and not by the legislature of Kosovo.
- 3) Receipts from foreign and domestic borrowing according to the IMF GSF are not considered tax or non-tax revenues. Borrowing does not increase net value as the increase of cash from these transactions is followed by increased liabilities. As a result, borrowing is not considered a budget revenues but a transaction to finance the deficit.
- 4) Receipts from deposits fund are not considered budget revenues as they do not present an increase in net value, but only a received value which until court disputes are resolved cannot be calculated as extraordinary revenues.
- 5) Receipts from one-off financing of PAK from the public sector perspective are not classified as budget revenues, as it presents a change in the type of asset, from a socially owned enterprise into cash. As a result, it is only classified as a financing item.
- 6) Return of loans from POEs is calculated as a negative expenditure, or as an item that reduces the total of expenditures. This is because the borrowing activity is a financing activity, but to ensure fiscal discipline. These loans given to POEs have been classified as expenditures in the past. For this reason, for calculation of the deficit, the return of borrowings of POEs is taken into account but not as a revenue, but as an item that reduces the value of expenditures.

### 3 Analysis of explanatory notes

Government and BOs have under control and manage public funds and use these resources to achieve objectives of service delivery. However, Government should be keeping records and have detailed information related to public funds that it manages.

IPSASB strongly encourages us to stick to the disclosure of additional information, where appropriate, in order to increase transparency and financial accountability. Disclosure of appropriate information in the AFS related to the general activities of the government can increase the transparency of financial reports and provide an opportunity for better understanding of the relationship between governmental activities and stakeholders.

The content of disclosures or annexes in the AFS should be clear and provide sufficient and qualitative information on all items of statements so that AFS users can better understand reported areas, namely annual budget trends and the reasons for changes.

In general, AFS contain numerous disclosures that provide detailed information on the content of figures in the three main statements. However, we think analytical presentation of figures in these three statements is not sufficient. Explanatory notes should be accompanied briefly also with words, especially in parts where changes are difficult to understand by users. Furthermore, in certain cases, no information was presented on certain categories such as of contingent liabilities.

#### 3.1 Consolidation of data from individual Statements with Government' Statements

The audit of individual statements and consolidation of data in the Government's financial statements has revealed a number of discrepancies. This is because some of the BOs have not recorded and presented correctly some items in their financial statements, which are mainly part of disclosures. The Ministry of Finance has consolidated the data as reported by individual organizations. We consider that deficiencies in consolidated figures do not affect the audit opinion, while they relate to the following issues:

- In the statement of disclosures in the AFS, assets were presented in the amount of €8,080,424,903, while according to individual audits, capital assets with value over €1,000 resulted being in the amount of €8,091,860,939. There is a difference of €11,436,036. In this case, assets were understated by €12,335,550<sup>12</sup>, and overstated by €899,514<sup>13</sup>. In four municipalities<sup>14</sup>, capital assets were not recorded in the KFMIS, and as a consequence were not presented in the consolidated AFS;

<sup>12</sup> MED, MoH, Municipality of Ferizaj, Kaçanik, Skenderaj and Shterpce

<sup>13</sup> Municipality of Prizren, Podujeve and Obiliq

<sup>14</sup> Municipalities: Zveçan, Zubin Potok, Leposaviq and Mamusha

- Assets with value under €1,000 presented in the statement of disclosures were in the amount of €75,132,992, while according to individual audits, the total of assets is €41,884,003, with a difference of €33,248,989. In this case, assets were overstated by €32,521,122 and understated by €727,867;
- Stocks in the statement of disclosures in the AFR of BRK were in the amount of €31,863,638, while according to individual audits this value is €16,001,781, with a difference or overstatement by €15,861,857;
- Outstanding liabilities at the country level in the statement of disclosures were presented in the amount of €199,410,813, while according to individual audit reports the total amount of outstanding liabilities was €205,667,026. Thus, there is an understatement of liabilities by €6,256,213;
- Accounts receivable were presented in the amount of €538,682,245, while according to individual audit reports, the total value of accounts receivable was €564,973,512, with an understatement of €26,291,267; and
- In the statement of disclosures were not presented contingent liabilities. Their value according to the audit was €141,767,247.

## 3.2 Basis of preparation, accounting policies and reporting

The Ministry of Finance, on behalf of the Government prepares the annual financial statements of the Budget of the Republic of Kosovo in accordance with LPFMA no. 03/L-048, as amended by Law 03/L-221, Law 04/L-116, Law 04/L-194, Law 05/L-063 and Law no. 05/L-007, as well as on the basis of IPSAS - *Financial Reporting under the Cash Basis of Accounting*.

Government's basis of accounting and reporting is the LPFMA and the IPSAS according to the cash principle. On this basis, the information presented in these financial statements present cash receipts and payments and cash flow.

According to the accounting principle of cash, Receipts (revenues) are recognized when the money is transferred into the Treasury account, are received in commercial banks and waiting to be transferred into the Treasury account, and the money collected by officials of budget organisations waiting to be transferred to the Treasury account at CBK.

Payments (expenditures) are recognized when they are out of the Treasury Single Account, while expenditures of petty cash and advance payments for official travel are recognized at the time of justification of the petty cash account and the official travel.

Management of money is organized in the form of the Treasury Single Account. The Treasury Single Account is a system of bank accounts that are used for revenue collection and incurring of expenditures, which are managed and controlled by the Treasury at the Ministry of Finance.

Treasury is also authorized to execute payment of invoices and payment requests pursuant to Article 39.2 of LPFMA and court and enforcement decisions under the Article 40 of LPFMA. Such

payments have been made out of different categories of funds that were available, namely available to meet the liability in accordance with LPFMA requirements.

The LPFMA has several additional requirements for presentation of non-financial assets and liabilities in explanatory notes to the financial statements, in accordance with Part 2 of the IPSAS based on cash.

Assets presented in Annex 6 are based on KFMIS data and include assets with value over €1,000, in accordance with the Financial Regulation 02/2013. The list of non-financial assets is presented in net accounting value, after the application of depreciation norms under this regulation.

The report contains disclosure of information for other accounts, which are presented in annexes:

(7) Assets with value under €1,000; (8). Stocks; (9). Receivables; (10). Liabilities; (14). Number of employees outside the payroll; (15). Number of employees with contracts for special services.

Transactions between Budget Organisations, called “Inter-departmental Transactions”, are not consolidated into these financial statements in order to maintain the consistency of information reported in individual financial statements of Budget Organisations.

Expenditures are categorized according to economic and functional classification of the Budget Law, based on IMF’s Government Finance Statistics (GFS), which are a version of GFS of 2014 based on cash.

Payments made by third parties are not considered receipts or payments in cash but are benefits of the Government. These payments are disclosed in the column *Payments by third parties* of the Consolidated Statement of Cash Receipts and Payments.

Cash is comprised of funds that held at the Central Bank of Kosovo, commercial banks, as well as cash into the cashboxes of BOs, and cash equivalents.

The reporting currency is Euro (€), while the disclosure of state debt is also in accordance with SDR (Special Drawing Rights), see Annex 18.

AFS are authorized on the date of signing of the declaration by the Minister of Finance and the General Director of Treasury.

### 3.3 Public Debt and State Guarantees

The overall state or public debts<sup>15</sup> consist of Foreign Debt, Domestic Debt, but for the purposes of calculation of the overall debt against GDP, in the category of debts are also considered state guarantees. As a source of budgetary funding, these borrowings are taken to cover budget deficits and to finance capital projects. Kosovo has borrowed from foreign sources since 2009, while since 2012, borrowing is also done from domestic sources.

The overall state debt balance at the end of 2017 was €996,420,000 (not including state guarantees). The table below shows the trend of debt over the last three years.

**Table 6 - Domestic and foreign state debt**

Description	Year 2017	Year 2016	Year 2015
International debt	422,150,000	373,770,000	371,170,000
Domestic debt	574,270,000	478,970,000	377,780,000
<b>Overall debt</b>	<b>996,420,000</b>	<b>852,740,000</b>	<b>748,950,000</b>
State Guarantees	44,000,000	20,000,000	10,000,000
<b>Overall debt + Guarantees</b>	<b>1.040,420,000</b>	<b>872,740,000</b>	<b>758,950,000</b>
Overall debt (% of GDP)	16.63%	14.58%	13.07%
GDP from KAS	6.257,000,000 <sup>16</sup>	5.985,000,000	5.807,000,000

The data in the table shows that the largest part of debt (57.6%) is from domestic borrowing, while foreign debts account for a lower percentage of 42.4%. As noticed, in the last three years, foreign debt has increased by 51 million, while domestic debts have increased by more than 196 million euros.

State guarantees present potential liabilities and they become factual debts only in cases when a public entity fails to pay guaranteed contractual obligations. In these cases, the Government has to pay the liabilities for the given guarantee. From the table it is seen that the Government has given guarantees for 44 million euros (two 10 million guarantees for 2015 and 2016, and in 2017 for 24 million).

<sup>15</sup> A special report on public debt was published by the NAO on June 2017.

<sup>16</sup> The amount of GDP of 2017 was taken from the Law on Budget Review 2017, as KAS does not publish this data until September 2018

Out of 996 million (excluding guaranties), 857 million are debts in euro currency and 139 million are Special Drawing Rights (consists of EUR, USD, GBP, Chinese Yuan, and Japanese Yen).

Public debt planned for 2017 had great variances between the initial planning, final budget and current borrowing at the end of the year. The initial budget was €360,876,000, the final budget was €221,000,000, while current borrowing at the end of the year resulted to €211,934,000.

The table below presents borrowings, purpose of borrowing and the amount of payments.

**Table 7 - Receipts and Payments from borrowing for 2017**

Description	Value
Receipts from Foreign Borrowing and for sub-borrowing	116,633,000
Receipts from Domestic Borrowing	95,301,000
<b>Total Receipts from Borrowing</b>	<b>211,934,000</b>
Payments of Debt and Interest	77,308,000
Financing of Budget deficit <sup>17</sup>	48,071,000
Increase of cash/bank balance at the end of year	86,555,000
<b>Total payments from borrowing</b>	<b>211,934,000</b>

### Foreign debts

At the end of 2017, the International Debt was €422,150,000, or 42.4% of the total debt, while compared to the GDP, the international debt was 6.75%.

<sup>17</sup> The difference of budget deficit of €586,000 was funded by PAK's one-off revenues of by €326,000, and the rest of €260,000 from other sources.

**Table 8 – Foreign debt per creditor**

Creditor	Ratified debt	Debt withdrawn	debt not withdrawn	Unreturned debt <sup>18</sup>	Unreturned debts
	(A)	(B)	(C=A-B)	(D=B-E)	(E)
IBRD	381,208,966	381,208,966	-	158,316,231	222,892,735
IDA	111,328,132	41,118,100	70,210,033	41,118,100	-
FMN	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	-	-
Foreign debt	1,080,474,920	784,665,542	295,809,378	422,152,157	355,741,643

Foreign debt is taken through bank loans from foreign financial institutions, where the main creditors up to now were IBRD and IMF with around 670 million, while domestic debt was created through the sale of securities by the Government in the form of Treasury bills (up to 1 year) and bonds (2 to 7 years). As purchasers of securities were mainly Commercial Banks and Pension Trust, but in small amounts also other physical and legal persons.

### Domestic debts

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

<sup>18</sup> The difference of unreturned debt varies depending on the exchange rate at the date of reporting, for loans that are in non-euro currency.

**Table 9 – Domestic debts in the last three years**

Domestic debt (net)	Year 2017	Year 2016	Year 2015
New Issuances	95,300,000	101,190,000	121,260,000
<b>Stock of domestic debt</b>	<b>574,270,000</b>	<b>478,970,000</b>	<b>377,780,000</b>
Domestic Debt (% of the GDP)	9.18%	8.00%	6.51%
GDP	6.257,000,000	5.985,000,000	5.807,000,000

**Return of domestic and foreign debts**

From the ratified debt since 2009 until 31.12.2017 in the value 1,080 million euro, the state has withdrawn 785 million euros, including also the Consolidated Loan C from Former Yugoslavia, as part of the State Debt of Kosovo, out of which by 2017 has returned 365 million. 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>19</sup> was prepaid in 2009.

The following table presents the data on the return of domestic and foreign debts, including return of principal, interest expenses, commitment fees and other fees as part of the debt.

**Table 10 – Expenses of foreign and domestic debt for the period 2009-2017**

Return of debts	Principal	Paid interest	Commitment fees	Other fees	Total payments
Foreign debt	232,030,000	79,320,000	890,000	2,140,000	314,380,000
Domestic debt	-	24,430,000	-	-	24,430,000
<b>Total:</b>	<b>232,030,000</b>	<b>103,750,000</b>	<b>890,000</b>	<b>2,140,000</b>	<b>338,810,000</b>

From the above data we see that €232,030,000 were returned out of the amount of principal. When adding the prepaid amount for the consolidated Credit towards former Yugoslavia of 124 million to this amount, it results that the total of returned loans is 356 million.

In line with international financial agreements, for the period 2009-2017, on behalf of securities (coupons of bonds and discount) and the interest for international loan, are paid nearly 104 million, while on behalf of commitment fees €890,000, and on behalf of other fees (managing tax, one-off fees etc.) are paid over 2.1 million.

<sup>19</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.

## State Guarantees

For the purpose of calculating the overall debt and to determine the ceiling of such debt, State and Municipal Guarantees are treated as debt. By the end of 2017, the value of state guarantees was 44 million euros.

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 issued 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.

## Audit conclusions

Funds from borrowing are not being used efficiently and effectively. Borrowing arrangements have taken place long before the conditions for using these funds were created. Due to lack of proper preparations to start execution of projects, the non-withdrawn value of ratified loans by the end of 2017 was €295,800,000. Out of six capital projects foreseen for 2014-2017 with value €188,000,000, were spent only €2,630,000.

Unused funds of €185,370,000 relate to following unfinished projects:

- The Project for improvement of road M2 Millosheva-Mitrovica, where the project implementer was the Ministry of Infrastructure;
- The Project for Improvement of the Education System in Kosovo, where the project implementer is the Ministry of Education, Science and Technology;
- Rehabilitation of Regional Roads, where the project implementer is the Ministry of Infrastructure;
- Rehabilitation of Railway 10, where the project implementer is the Ministry of Infrastructure and Infracos;
- Health project, where the project implementer was the Ministry of Health; and
- The Project for Measures of Effective Energy in Municipalities', implementers of the project were municipalities: Ferizaj, Prishtina, Gjakova, Gjilan.

In addition to setbacks in project implementation, we have also identified advance payments, which were carried out more than a year ago, but the equivalent of payment has not yet been received. An agreement for the purchase of angiography device was signed on 29 October 2015 and was ratified by the Assembly on August 4, 2016 in the amount of €2,600,000.

In November 2016 was paid €2,110,000 an advance for the purchase of this device, while due to the fact that the space for this equipment was not adapted according to required standards, the device has not yet been brought to the University Clinical Centre of Kosovo (Cardio-Surgery Clinic) by the supplier. 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.

**Recommendation for the Government**

- The Government should regularly review annual reports on public debts of the Ministry of Finance and discuss comprehensively the need to get debts, results and setbacks in the process, as well as to strengthen measures related to efficient and effective use of borrowed funds.

**Recommendations for the Ministry of Finance**

- Based on quarterly reports of the Treasury, the Ministry of Finance should address all challenges identified by line Ministries in implementing projects financed by the borrowing. At any time and in all cases when deemed necessary, adequate measures to overcome difficulties should be suggested to the Government; and
- The MoF should draft clear guidelines for budget organisations for inclusion of capital investment plans that are to be financed by borrowing. Approval of projects should be done only if they have completed all preparations and provide sufficient and documented assurance that implementation of projects will be done in a timely manner.

## 4 Assets

The primary objective of the Government in the area of assets management is that budget organisations maintain accurate data on assets through systematic maintenance of assets registry as an integral part of KFMIS, for the purpose of valuation and reporting of their value, and effective process of assets management.

Budget organisations are obligated to maintain records of assets and to continuously update them in the KFMIS according to MoF Regulation no. 02/2013 on the Management of Government Assets. Assets of public institutions as a whole are divided into:

- Capital assets that have a service life of more than one year, and have a financial value of over €1,000, and
- Non-capital assets that have a service life of more than one year, and have a financial value of less than €1,000. In both cases, ownership and control of benefits remains with the organization that manages assets.

Assets are managed through two systems: KFMIS accounting register as an integrated system within the MoF, where are recorded assets with value over €1,000, and the “E-assets” application, which is an integrated electronic system within the MPA, where all public institutions should record, manage and report on their assets under €1,000.

Budget Organisations have reported different values in the individual AFS, which figures were consolidated in the Statements of the Ministry of Finance. Upon the audit of the individual statements, we have noticed discrepancies between figures reported and values audited.

Main findings related to assets reporting are:

**Assets of Central Institutions** - The net value of capital assets presented in the AFS is €2,370,301,102, whereas according to individual audits their value is €2,378,338,918. There is a discrepancy of €7,863,189, respectively an understatement of Government’s AFS in relation to the status of the audit.

The net value of non-capital assets presented in the AFS is €60,406,358, whereas according to audits €28,880,236. The discrepancy of €31,526,122 is a result of overstatement of values presented in the AFS.

In addition to ineffective management and weak controls, the issues have most frequently encountered during the audit of assets at Central Institutions are:

- In four (4) institutions are missing internal procedures on assets management;
- In eight (8) institutions we have encountered inoperable e-assets system;
- In five (5) institutions there were no reconciliation of data between the general assets register and inventory report;

- In four (4) cases, was not calculated the depreciation of assets in the e-assets system according to established norms;
- In five (5) institutions was not conducted the inventory; and
- In one (1) case were not reported assets under €1,000 to the MoF.

**Municipal Assets** - The net value of capital assets presented in the AFS is €5,710,123,801, whereas according to the audits it is €5,713,696,648. The discrepancy between the AFS and values according to the audit is €3,572,847, and as a result, AFS are understated.

The net value of non-capital assets presented in the AFS is €14,726,634, whereas according to the audit, their value is €13,998,767. There is a discrepancy of €727,867, which presents an overstatement of assets under the AFS.

Even in 2017, municipalities have not managed to complete assets recording process.

Other findings in the area of assets at municipalities are:

- Municipality of Mamusha and Leposavic have not presented any values on assets;
- Municipality of Partesh had not reported on assets under €1,000;
- Municipality of Ferizaj, Zvecan, Novoberde, Zubin Potok and Klllokot have reported assets under €1,000 with a zero value;
- Twenty-five (25) municipalities have not recorded assets purchased during the current year;
- In nineteen (11) municipalities the e-assets system was not operational;
- In seven (7) municipalities was not done the reconciliation of data between the general assets register and the inventory report; and
- In seven (7) municipalities there is lack of evidence and delay in assets inventory.

Other identified shortcomings are: physical counting and evaluation of assets, incomplete assets inventory reports, inadequate categorization of assets, depreciation, alienation and incorrect classification of incomplete investments. Budget Organisations also have uncertainties related to recording and updating of assets with accounting value of zero.

**Recommendations for the Government**

The Government should analyse deficiencies in the area of assets management and ensure that:

- All Budget Organisations maintain complete and accurate registers of assets in financial as well as quantitative aspect; and
- All Budget Organisations establish committees for recording of and evaluation of assets in line with Regulation MoF No 02/2013 on Management of Assets;

**Recommendations for the Ministry of Finance**

- The Ministry of Finance should ensure unobstructed access to recording of and updating in the accounting register of KFMIS;
- Calculation of assets depreciation is done in accordance with norms set out under the regulation; and
- To define policies and through training to provide clear instructions on how to handle assets with accounting value of zero.

## 5 Accounts receivable

Accounts receivable and their status present a very important element in the overall budget aspect, and as such have become a matter of attention every year. For 2017, the total amount declared of these accounts in the consolidated financial statements for the central and local level is €538,682,245, whereas according to audits the total value of these accounts is €564,973,512. The understated value in statements is €26,291,267. This difference is due to the lack of poor controls of Budget Organisations in the area of reporting, whereby records reported in the AFS do not match to the factual state of accounts. Compared to 2016, these accounts have increased by €22,692,194 or 4%.

**Table 11 - Comparison of Accounts Receivable in the last two years**

Description	According to 2017 audit	According to 2017 AFS	According to 2016 AFS
Central level	402,730,000	377,127,000	371,241,000
Local level	162,243,000	161,554,000	144,748,000
<b>Total</b>	<b>564,973,000</b>	<b>538,681,000</b>	<b>515,989,000</b>

### Accounts receivable of the central level

The value presented in the AFS 2017 was €377,127,395, which during the audit was confirmed that were understated by €25,602,881, as this should have been presented in the amount of €402,730,276.

The largest part of this difference derives from statements of the Independent Commission for Mines and Minerals where was presented only the uncollected invoicing of the current year, and not the state carried forward from previous years. In addition, a part of the difference derived from an error in the statements of the Ministry of Internal Affairs, as were not included receivables from traffic fines, namely, uncollected receivables from tickets up to €60.

Over 90% of accounts receivable of the central level consist of receivables from Customs and TAK, namely from the Ministry of Finance (€364,472,000). Compared to the previous year, accounts receivables have an upward trend by 2%.

### Accounts receivable for central level

The balance of receivables in 34 municipalities<sup>20</sup> reaches €161,554,850, but this amount does not match to the total of audited individual reports by €688,386.

<sup>20</sup>Mitrovica North, Zvečan, Leposavic and Zubin Potok have not reported on accounts receivable, as they do not apply property tax or other charges that generate receivables. It is worth mentioning that property tax is budgeted year after year to be collected by these municipalities, but no specific measures have been taken in this regard.

According to the audit, the amount that should be presented as the balance of Receivables at the municipal level is €162,243,236. This difference is due to non-reconciliation of data in a manual form and due to poor reporting and monitoring discipline by relevant municipal departments. Some adjustments made by municipalities are done after the submission of the AFS to the Treasury, and consequently were not reflected in the consolidated financial statements.

This category is dominated by the property tax, which includes current charges as well as interest rates and penalties for failing to meet earlier liabilities. Generating accurate data on property tax has been challenging when drafting individual financial statements. In April 2018, the NAO published a report on the effectiveness of the property tax system, whereby were identified a significant number of irregularities.

Among others, was reported on the failure to process payments in the current system, which also risks the accuracy of reporting of accounts receivable. Furthermore, for a number of buildings that are under the management of the Privatisation Agency of Kosovo, liabilities have not been met for years. Different from property tax, which is managed through the application 'ProTax', the rest of data of accounts receivable are completely maintained manually in Excel or Access spreadsheets. This increases the risk of controls due to unauthorized modification of data.

The upward trend of receivables balance is greatly related to reported weaknesses regarding the mandatory forms of collection, late charges and invoicing as well as to their maturity. Municipalities have declared receivables that date back to 2002, which makes the collection more difficult. Compared to 2016, Receivables have increased by 12%.

Due to lack of complete information on receivables are risked proper budget projections, while due to poor collection is risked implementation of foreseen projects. Lack of efficiency and policies to take measures against debtors creates a precedent for responsible debtors, where failing to carry out liabilities on time usually does not constitute a punitive act.

#### **Recommendation for the Government**

- The Government should address the problem of management of these accounts with Customs and Tax Administration, as uncollected debts from these two agencies consist around 65% of the total debts of citizens and other legal entities.

## 6 Outstanding liabilities and contingent liabilities

The value of outstanding liabilities at the end of 2017 is €199,410,813, which compared to 2016 has decreased by €16,271,187, or around 8%.

Liabilities have increased only in local level organizations, while in the central level there is a reduction in liabilities. The following table presents outstanding liabilities based on the level of government and the trend over the last three years.

**Table 12 - Outstanding liabilities in the last three years**

Description	2017	2016	2015
Central level	170,333,953	200,275,000	191,816,000
Local level	29,076,860	15,407,000	15,445,000
<b>Total</b>	<b>199,410,813</b>	<b>215,682,000</b>	<b>207,261,000</b>

Out of the amount of outstanding liabilities, around 85% of their total belongs to the central level, out of which 74% relate to:

- Ministry of Environment and Spatial Planning, €120,744,000, that mainly relate to the expropriation process;
- Ministry of Infrastructure, whose liabilities are €22,588,872, that mainly relate to the category of capital investments. Most of outstanding liabilities (€15,306,323) belong to the Bechtel & Enka and relate to the construction of the motorway Prishtina - Hani i Elezit, while the rest relates to subsidies and goods and services; and
- Ministry of Agriculture, which has presented liabilities in the amount of €9,324,498, out of which €7,009,157 are contractual obligations for grants which are expected to be implemented during 2018, while the amount of €2,225,341 are outstanding invoices.

Outstanding liabilities (except for those for expropriations and grants) are as a result of lack of sufficient funds to pay them, and due to late receipt and processing of invoices<sup>21</sup>.

In addition, the quality of reporting was also poor. In certain cases, BOs had not reported their liabilities regularly to the MoF, and in some other cases reported liabilities were not complete. In addition, a significant number of BOs were late in paying invoices, which causes negative effects on budget management, by burdening budgets of the next year, and by preventing achievement of planned objectives.

<sup>21</sup> Data from analysis of liabilities in five (5) BOs that have the highest amounts of debts.

## Contingent Liabilities

Contingent liabilities are different claims by plaintiffs who are likely to create financial liabilities in the future for budget organisations depending on court decisions that may be in favour of plaintiffs. These relate to compensations for expropriations, debt compensation, material damage, wages and other compensations.

The amount of contingent liabilities<sup>22</sup> at the end of 2017 according to the audit is €141,767,247, which compared to 2016 has increased by €86,668,067. The following table presents the comparative data for the last three years.

**Table 13 - Contingent liabilities in the last three years**

Description	2017	2016	2015
Central level	75,602,000	28,953,000	14,270,000
Local level	66,165,000	26,146,000	87,099,000
<b>Total</b>	<b>141,767,000</b>	<b>55,099,000</b>	<b>101,370,000</b>

Around 53% of the total contingent liabilities belong to the central level, out of which 55% relate to the following entities:

- Authority of Electronic and Postal Communications, whose liabilities are estimated at €15,355,486, are almost entirely of this year. If the lawsuits result in favour of the parties during 2018, the budgetary impact will be great even for the Government, as for 2018 the initial budget for AKEP is only €1,502,744;
- The Ministry of Infrastructure has such liabilities in the amount of €14,708,862, which potentially can turn into factual debts. Ministry even last year had a similar situation of liabilities (€14,407,675), which if they take place will burden the budget of following years; and
- Towards the Ministry of Finance, there are claims for such debts in the amount of €11,846,000, which mainly relate to lawsuits against the Kosovo Customs (99%). It is worth mentioning that the Ministry of Finance did not have a good practice of cooperation with the State Advocacy Office in order to confirm this information, and regarding this was given a recommendation on the audit report of the MoF.

In the overall level of contingent liabilities, municipalities participate by €66,165,280 or 47% of total liabilities. Only the municipality of Rahovec had contingent liabilities of €32,499,129, whereas in its AFS these liabilities were understated by €29,312,700.

On individual audits, we have found large discrepancies between the liabilities reported by the BOs and the factual state of liabilities.

<sup>22</sup> Contingent liabilities are potential financial liabilities that may occur in the future as a result of lawsuits and different disputes against budget organizations.

The following table presents differences between audited figures and those presented in the AFS of organizations.

**Table 14 - Presentation of liabilities according to the AFS and audit for 2017**

Description	According to audit	According to AFS	Difference
Central level	75,602,000	60,603,000	14,999,000
Local level	66,165,000	36,876,000	29,289,000
<b>Total</b>	<b>141,767,000</b>	<b>97,479,000</b>	<b>44, 288,000</b>

Related to these liabilities there is no accurate information in the AFS of Budget Organisations. The difference between the audited figures and the values presented in the AFS is €44,288,713. These differences arise as a result of lack of adequate coordination between Ministries, Municipalities and the State Advocacy on cases/information over the issue of contingent liabilities.

The Ministry of Finance as in previous years, had not disclosed in the AFS the consolidated amount of contingent liabilities in the AFS of Budget Organisations.

## 7 Payments according to Article 39.2 of the LPFMA

For 2017, the Treasury has executed payments in the amount of €8,604,163, according to the Article 39.2<sup>23</sup>. Compared to 2016, direct payments executed have increased by €3,698,355 or 76%.

**Table 15 - Payments according to article 39.2 of the LPFMA**

Payments per categories	Total 2017	Total 2016	Total 2015
Goods and Services (Utilities)	1,892,000	666,000	886,000
Subsidies and Transfers	316,000	0	0
Capital Investments	6,396,000	4,239,000	3,515,000
<b>Total</b>	<b>8,604,000</b>	<b>4,905,000</b>	<b>4,401,000</b>

Below we have presented some of the BOs which have payments executed in higher amounts, based on Article 39.2 of the LPFMA:

- Municipality of Prizren €1,401,073;
- Municipality of Prishtina €1,059,488
- Municipality of Decan €1,055,876
- Ministry of Infrastructure €728,254; and
- Municipality of Leposavic €659,359.

The main reason behind payment of invoices directly by the Treasury is due to entering into liabilities without prior commitment of funds, liabilities inherited from past governances at the local level, negligence and irresponsibility of officials accountable to pay invoices on time, etc.

This manner of carrying out payments can increase the risk of continuing such practices by BOs under the assumption that at the end of the process the Treasury will carry out these payments. When reviewing the process of these payments, we noticed in files lack of sufficient evidence on payments by the Treasury for the period before the change of the procedure, and shortcomings in necessary procedures required under the LPFMA for payment of these invoices. In one case, we have noticed that the same invoice was paid by the Treasury (March 2017) and the Municipality of Leposavic (April 2017), for which case we informed the Treasury during the audit process, and the Treasury responded immediately and returned the funds into the account, according to budget law on budget appropriations.

Due to some shortcomings identified in the process, the Treasury had taken the initiative and reviewed and advanced the procedure for outstanding invoices/ payments delays, and in October 2017 had approved the new procedure for handling of suppliers' requests for late payments and outstanding liabilities under the Article 39.2 of LPFMA. From files analysed resulted that with this procedure clearly describes procedures from the request up to the execution and payments' report.

<sup>23</sup> LPFMA Article 39.2 "When an invoice has not been paid by BOs for a period longer than 60 days, the Operator has the right to request execution of payment directly from the MoF/Treasury.

## 7.1 Payments based on court decisions

In 2017, based on court decisions were carried out €11,544,224. Compared to 2016, the amount of these payments has increased by €5,192,224 or 82%.

**Table 16 – Payments based on court decisions**

Payments per categories	Total 2017	Total 2016	Total 2015
Wages and salaries	34,000	117,000	0
Goods and Services (Utilities)	2,251,000	1,949,000	1,737,000
Subsidies and Transfers	373,000	404,000	949,000
Capital Investments	8,886,000	3,881,000	4,410,000
<b>Total</b>	<b>11,544,000</b>	<b>6,351,000</b>	<b>7,096,000</b>

Failure by budget organisations to timely meet liabilities has caused costly and complicated court procedures, and additional budget expenditures. In addition, these delays have adverse effects on the credibility of public institutions.

Below are some of the BOs that have executed payments in larger amounts, based on court decisions:

- Ministry of Environment and Spatial Planning €2,442,071;
- Municipality of Ferizaj €1,085,074;
- Ministry of Internal Affairs €892,143; and
- Municipality of Prishtina €887,766.

## 8 Employment data

Approved number of employees under the Budget Law for the central level (Ministries and Independent Institutions) was 39,407, while the current number of employees is 37,048. As seen, 2,359 positions that were approved under the budget law during the year were not staffed.

While at the municipal level, the number of employees approved under the budget law was 43,871, while the actual number of employees was 42,098. Thus, even in municipalities 1,577 positions that were approved under the budget law had remained vacant.

The main reasons why these positions were not staffed according to the data above is due to delays in recruitment procedures, staff resignations, non-allocation of the budget by the Ministry of Finance, due to budget constraints etc.

When it comes to funds that have remained in the category of Wages and Salaries due to not staffing the approved positions, with the final budget a portion of these funds went to surplus, while another portion foreseen for those positions were adjusted with the budget review, in those cases when budget organisations considered that they will be able to staff them within the year.

### 8.1 Employees outside the payroll list and with special service contracts

#### Number of employees outside the payroll

In 2017, according to the AFS the total number of employees outside the payroll list at the central level was 461 (in ministries and independent institutions). Out of these, the largest number of employees outside the payroll were in the Kosovo Hospital and University Clinical Service (387). These employees are under specialisation and specialists who are not on the payroll list in UCCK, but are present only to provide on-duty work<sup>24</sup>. The reasons why they were not recruited under regular recruitment procedures was due to lack of budget. The rest of the employees outside the payroll list mainly relates to those engaged in projects financed by donors.

When it comes to employees outside the payroll list in independent institutions (741), they are experts for which the organization does not have a constant need. While, at the municipal level the number of employees outside the payroll was 324. Some of these employees were engaged in projects financed by donors, and some were paid out of the category of goods and services as a contracted service.

#### Special Services Agreements

Based on AFS, the number of those engaged with special services agreements in 2017 in central level institutions (Ministries and Independent Institutions) was 1,886. Compared to last year, where the number of those engaged was 613, this year we have an increase by 1,273 or three-fold.

<sup>24</sup> Doctors in specialization have a contract with the MoH to do specialization, while specialist doctor that are not in employment relationship at UCCK, but in other Institutions have contracts for special work with dedication, to hold on-duty work or other certain jobs.

If we analyse the data from last year (2016) and compare it to the 2017 data, we can say that the number of those engaged with special services agreements in independent institutions has increased by 855 or 566%. However, this significant number was due to 904 more employees engaged last year by the CEC due to the extraordinary elections. If we ignore this increase in the CEC and assume that the number would be equal to the previous year, then it turns out that there are 49 less engaged than in 2017 (or the number of employees engaged has decreased by 33% compared to the previous year).

There is a same situation in local level institutions that had engaged 2,929 employees with special services agreement, which compared to 2016 where the number of these employees was 1,376, this year we have an increase by 1,553 compared to a year ago.

Key issues that have resulted from individual audit reports for 2017 in terms of employees engaged through special services agreements were: engagement without recruitment procedures as required under legal rules; period of engagement was longer than the deadline foreseen under applicable rules, failure to withhold taxes and contributions of these employees, and contracts concluded for these positions were for regular positions, and not for experts in relevant fields for what this kind of engagement is allowed.

### Recommendations for the AFS of the Government

#### **We recommend the Minister of Finance and the General Director of Treasury to:**

- Establish effective processes ensuring that the drafting process of AFS/BRK for 2018 addresses all issues that relate to compliance and financial reporting requirements. Issues raised on the basis of the opinion should be addressed as priority issues in the area of improvements. Budgeting of expenditures should be done in an adequate economic categories. Furthermore, the consolidation process should include complete assets recording and reporting as well as additional information on contingent liabilities;
- Ensure good planning by central government BOs that generate non-tax revenues (taxes, charges and other) in order to avoid current planning practices based on historical data and only of total amounts;
- Ensure that the Ministry of Finance in coordination with municipalities to develop a more efficient process of monitoring and evaluating of the revenue collection plan, to identify the causes behind non-fulfilment of the plan, and this should be reflected in budget planning;
- Ensure a more qualitative and accurate reporting of contingent liabilities, and to establish a better communication of the State Advocacy Office with the institutions it represents, so that parties against which lawsuit was filed have timely information related to disputes and lawsuits; and
- Ensure that Treasury/Monitoring Division strengthens controls over the payment execution process according to the article 39.2, by providing a complete and substantiated analysis backed by evidence. A more critical review of reports on outstanding liabilities is needed and when the delays and the value of liabilities is material, the issue should be addressed to senior officials in the accountability chain of the respective organization.

## Part II – General

### 9 Implementation of recommendations

The importance of audit reports lies in identification of weaknesses in governance systems, especially financial systems, while implementation of audit recommendations serves as a mechanism for elimination of these weaknesses and in making systems more efficient and effective in achievement of objectives. Analysis in this area has revealed that current level of implementation of audit recommendations is not satisfactory.

After receiving the AAR for 2016, the Government prepared an action plan for implementation of recommendations, and it was sent to the Assembly (COPF), but the progress achieved was not reported.

At the level of individual audits, most of budget organisations do not implement a systematic process for monitoring of implementation of recommendations. Due to this only a small number of recommendations have been fully implemented, while most of them are in process of implementation or not implemented, including recommendations from previous years. Setbacks in fully implementing recommendations have impact on repetition of control weaknesses and systematic repetition of irregularities from year to year. Causes and reasons that have led to poor progress are different, which will be explained below.

The impact of audit is measured by the level of implementation of recommendations, and is the best indicator whether the management is improving existing processes and controls in areas where irregularities have been identified.

The NAO, through individual audits also assesses the implementation of recommendations given in the previous and earlier years, clearly reflecting on areas in which corrective measures and actions have been taken, as well as areas where no changes have been noticed.

Annex II of the report provides complete information on the progress of recommendations given in AAR, while Table 17 and 18 presents statistics of recommendations for individual organizations.

In performance audits, implementation of recommendations is measured by conducting specific assessments that are also known as the “the follow up stage”.

Issues and recommendations for Publicly Owned Enterprises will be addressed in a separate section of this report.

## 9.1 Implementation of recommendations given in the AAR for 2016

In the AAR for 2016, the Auditor General had recommended the Assembly to request from the Government a report on recommendations given in the AAR of 2015, and to prepare an action plan for implementation of recommendations given in the AAR of 2016, as well as reports regarding the progress of this plan on quarterly basis.

In December 2017, the Government of Kosovo had approved the Action Plan for implementation of recommendations, whereby obligating all budget organisations to implement it. For the first time, the same was sent to the Assembly of Kosovo (COPF). However, according to the COPF, the plan was not reviewed by this Committee due to lack of participation of Government representatives.

The Government has not prepared any progress reports on periodic basis for the COPF.

Based on information gathered during the audit process for budget statements as well as individual audits, we have noticed that actions undertaken by the Assembly of Kosovo, Government and other institutions have reflected with little progress on implementation of recommendations compared to previous years.

Out of 47 recommendations<sup>25</sup> given, eight (8) were fully implemented, 11 were in the process of implementation, and 17 were not addressed yet. For 11 recommendations given in performance audits, remains to be conducted a follow up audit on their implementation in order to make an accurate assessment of the progress. Annex II presents detailed data on recommendations given in the AAR 2016.

Issues and recommendations for Publicly Owned Enterprises will be addressed in chapter 16 of this report.

Due to non-implementation of recommendations, certain weaknesses and irregularities have been repeated, particularly in areas such as:

- Incorrect reporting of expenditure on the AFS due to misclassification and insufficient disclosure of information;
- Weaknesses in governance related to self-assessment and risk management;
- Weakness in procurement procedures;
- Lack of internal audit services for small independent institutions; and
- Inefficient management of resources in municipalities.

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<sup>25</sup> 14 recommendations were given to the Assembly of Kosovo, 24 to the Government, 7 to the Board/Shareholders of POEs, and 2 to Municipal Assemblies. Out of these recommendations, 11 were given in relation to performance audit.

## 9.2 Implementation of recommendations given in individual reports 2016

Assessment of implementation of recommendations is an on-going part of the audit process. The assessment of how and how many have been implemented is done for each budget organization during the regular audit, and the results for the previous year are presented in the audit reports for the following year.

The table below presents the data on the status of 2016 and 2015 recommendations, which are categorized according to audited organizations.

Audited organizations are divided into central level Institutions<sup>26</sup>, Independent Institutions<sup>27</sup> and Local Government Institutions (38 municipalities).

The table below shows the number of recommendations given and the percentages of their implementation.

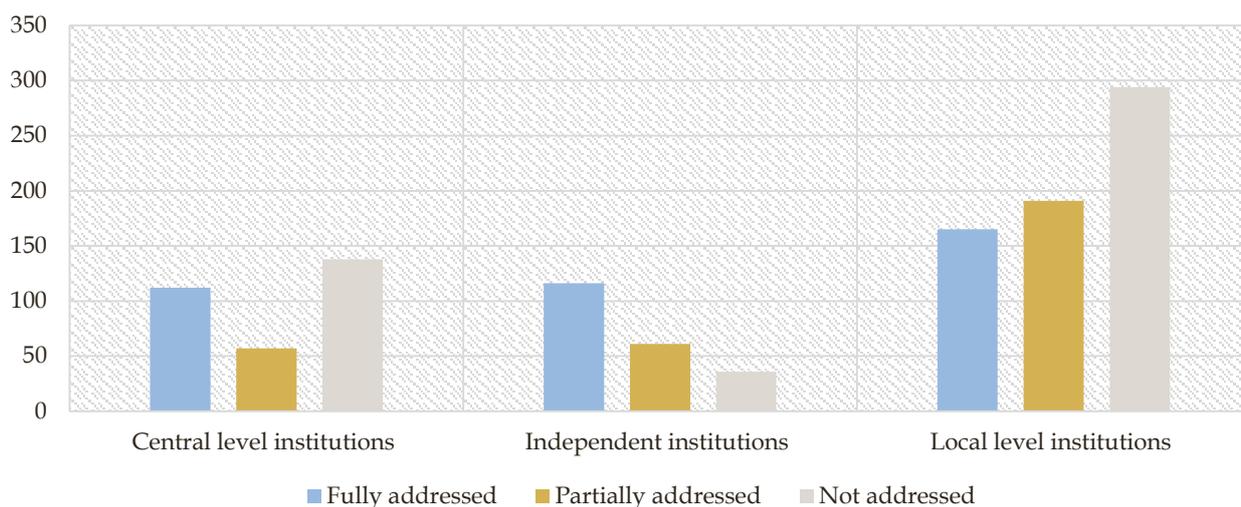
**Table 17 - Implementation of recommendations for 2016 by budget organisations**

Audited entities	Number of recommendations	Fully implemented		Partially implemented		Un implemented	
		No.	%	No.	%	No.	%
Central level institutions	307	112	36%	57	19%	138	45%
Independent institutions	220	118	54%	63	29%	39	17%
Local level institutions	650	165	25%	191	29%	294	45%
<b>Total recommendations</b>	<b>1,177</b>	<b>395</b>	<b>34%</b>	<b>311</b>	<b>26%</b>	<b>471</b>	<b>40%</b>

The following chart presents the progress of recommendations per institutions.

<sup>26</sup> Ministries 20 (for 2016 was not included the MLGA - contracted audit), Office of the Prime Minister, TAK, Customs and KHUCS

<sup>27</sup> Independent institutions include the Kosovo Assembly, the Office of the President and 28 institutions

**Graph 1: implementation of recommendations of 2016****Table 18 - implementation of recommendations of budget organisations for 2015**

Audited entities	Number of recommendations	Fully implemented		Partially implemented		Un implemented	
		No	%	No	%	No	%
Central level institutions	338	93	28%	126	37%	119	35%
Independent institutions	184	52	28%	70	38%	62	34%
Local level institutions	640	153	24%	229	36%	258	40%
<b>Total recommendations</b>	<b>1,162</b>	<b>298</b>	<b>26%</b>	<b>425</b>	<b>37%</b>	<b>439</b>	<b>38%</b>

From tables above we see that the number of recommendations given compared to the previous year (2015) is increasing, which is presented by the level of institutions, but also the level of unimplemented recommendations is increasing.

In general, budget organisations do not pursue any formal monitoring, evaluation, or reporting process over the level of progress. This reflects lack of responsibility to ensure that recommendations are implemented on time and to identify and address obstacles that hinder actions.

In order to improve the situation, greater commitment and accountability by persons responsible is needed including regular monitoring of implementation of recommendations by all BOs.

### Implementation of recommendations given in performance reports

The purpose of our recommendations in performance audits is to improve the process of effective implementation and functioning of the government systems, programs and activities.

Recommendations are addressed to audited entities so that they improve their approach towards spending of public funds.

Monitoring of implementation of recommendations from individual performance audit reports is done through special audits, which are also known as the “follow up stage”. Following this process, the results on implementation of recommendations are produced.

Performance audit reports are also in the focus of review by the Kosovo Assembly, namely the COPF. While, this year was only reviewed the performance report “The process of review of textbook”.

### **Reasons for low implementation of recommendations**

The lack of formal processes for proper and systematic monitoring of action plans for implementation of recommendations, and lack of adequate commitment to address them are among the main causes for such low level of implementation of recommendations. In addition, lack of effective oversight by the Government and oversight bodies has led budget organisations to avoid complete and consistent implementation of financial management guidelines as a result of which recommendations are repeated.

In order to increase the level of implementation of recommendations, additional measures are needed by the Government against BOs, and strengthening of accountability measures towards the Assembly of Kosovo.

#### **Recommendations for the Assembly of the Republic of Kosovo**

- To ensure that after receiving this report the Government prepares an action plan for implementation of recommendations, and the same is reviewed by the COPF. In addition, to ensure that the plan incorporates all recommendations given, and clearly determine actions, timelines and persons responsible for implementation of recommendations and their monitoring; and
- At least twice a year to review the progress made on recommendations given, to strengthen accountability measures and propose measures for elimination of all obstacles that may hinder implementation of recommendations.

#### **Recommendation for the Government**

The Government should establish an effective monitoring process of action plans for implementation of recommendations, and discuss with BOs all effective measures that can improve the process, in particular strengthening of accountability measures over managers that responsible for failures in implementation of recommendations.

#### **Recommendation for Municipal Assemblies**

Mayors of municipalities should discuss on a regular basis reports of managers responsible for implementation of action plans, and at least twice a year to report to the Municipal Assembly on the progress and challenges in this area.

## 10 Opinions on Individual Audit Reports

The NAO has carried out regularity audits of AFS for 2017 in 92 Budget Organisations. Audit Opinions are presented in the following table, while audit findings are presented in the individual reports of BOs.

**Table 19 - Number and types of opinions given**

Audited entities	Unmodified opinion	Unmodified opinion with emphasis of matter	Qualified opinion	Qualified opinion with emphasis of matter	Adverse opinion with emphasis of matter	Total
Central level organisations	5	13	1	3	1	23
Municipalities	4	25	0	9	0	38
Independent institutions	23	6	2	0	0	31
<b>Total</b>	<b>32</b>	<b>44</b>	<b>3</b>	<b>12</b>	<b>1</b>	<b>92</b>

As seen from the table, auditing of individual statements of audited organizations has resulted in 76 unmodified opinions and 16 modified opinions (15 qualified opinions and 1 adverse opinion). Broken down more specifically, in 83% of cases audits in the sense of reporting present true and fair view of AFS, and in 17% of cases statements have resulted in material errors and irregularities.

### 10.1 Recommendations given in individual reports for 2017

In addition to audit opinions, individual reports of BOs also contain recommendations for improvement for each area where errors and irregularities have been identified. The following table presents details over the number of recommendations given in the last three years.

**Table 20 - Number of recommendations given in individual reports**

Audited entities	Year 2017	Year 2016	Year 2015
Central level institutions	363	306	338
Municipalities	600	650	640
Independent institutions	166	229	184
Total recommendations	1,129	1,185	1,162

The data above show a slight decline in the number of recommendations given during 2017, compared to the two previous years.

## 11 Good Governance

State institutions are responsible to establish and develop functional and effective internal control systems. Financial Management and Control should be implemented in all programs, operations and processes of governance and administration with public funds.

Good governance is marking a slight progress from year to year, but good governance principles need to be developed further. Regarding this, in recent years the Ministry of Finance has designed and launched a self-assessment form which needs to be completed by budget organisations and submitted each year to the MoF.

Establishment of a self-assessment process by the Ministry of Finance has put BOs under pressure to present their situation as fairly as possible in terms of implementation of PIFC framework. Our audit observations reveal that the process and the impact of self-assessment is still being accompanied by deficiencies in terms of quality, or even in taking actions to address existing challenges.

The most emphasised challenges faced by budget organisations are that: although there are various strategies drafted by Budget Organisations, they are not implemented or monitored in order to establish whether the objectives are being achieved. Furthermore, even though most of the organizations have drafted a list of risks, this list is not being updated and monitored as required under the FMC procedures. In addition, challenging remains also the unsatisfactory level of implementation of internal audit recommendations and the poor support of the Audit Committees for Internal Audit Units of Budget Organisations.

In April 2018 has entered into force the Law on Public Internal Financial Control that regulates the internal control system of public finances, which includes financial management and control, internal audit, and their reconciliation, in accordance with international standards on internal control and internal audit.

Individual reports show that good governance at BOs in 2017 has been accompanied by significant shortcomings, which we are presenting below:

### Central level institutions:

- Out of 24, one of them had not drafted the Strategic Plan;
- Three of them had not drafted the risks register;
- Eight had not undertaken the assessment, monitoring and updating of the risks register;

### Municipalities:

- 21 municipalities have not yet drafted a list of risks that the organization may face;
- 24 municipalities have resulted with poor quality of reporting and accountability;
- 10 municipalities, although submitted the self-assessment questionnaire to the MoF, it only partially reflected the real situation and was not supported by sufficient evidence;

- 9 municipalities do not have a Strategic Plan yet; and
- 4 municipalities had submitted the self-assessment questionnaire to the MoF.

**Independent institutions:**

- Out of 30, four did not draft the Strategic Plan;
- Although two had drafted the Strategic Plan, it was not approved by the government due to high cost;
- 6 have not yet drafted the risks register;
- 13 had drafted the risks register, but was not done assessment, monitoring and update of the register;
- Even though six have submitted the self-assessment questionnaire to the MoF, they are of poor quality and do not present the real situation.

## 11.1 Internal Audit System

Internal Audit (IA) is an important function of the system that assures the senior management that internal control mechanisms are designed and function properly. Audit Committee (AC) is an advisory and support body for internal auditors so that they fulfil their function better and to maintain independence.

One of the objectives of the Public Internal Financial Control Strategy (PIFCS) 2015-2019 is advancement of the IA through implementation of the program for professional development, quality assurance for compliance and updating of the legal framework. Thus, the importance and sensitivity of the profession obligate IAs to have the appropriate professional level.

In 2017, the number of certified internal auditors compared to the previous year has increased from 98 to 128<sup>28</sup>.

As positive developments within the PIFCS 2015-2019 can be pointed out:

- In the first half of 2018 was approved the Law on Internal Control of Public Finances; and
- The Minister of Finance has approved the “Book of Processes for management of Public expenditures”, which is a document that identifies risks in some of the PIFC areas, and provides an analysis and guidance on management of these risks.

The CHU/IA is the coordinator of the entire internal audit process and among others has monitored 10 public sector entities for public internal financial control and has conducted monitoring of 10 internal audit units.

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<sup>28</sup> See the Annual Report of the CHU on Functioning of PIFCS for Public Sector 2017

Our focus on the internal audit for 2017 has included a common evaluation of several key areas such as:

- AI no.23/2009 on Establishment and Functioning of IAUs determines criteria that should be met for the establishment of the IAU, and determines the minimum number of auditors that the BO should have. Based on these criteria, we identified that eight municipalities<sup>29</sup> had not established the IAU despite the fact that they meet the criteria. Regarding the sufficient staff members, out of 73 BOs that have established the IAUs, 33 of them had less auditors than foreseen under the AI no. 23/2009;
- Regarding the actions undertaken by managements of BOs in implementation of recommendations, we have noticed that 48.6% of recommendations given had been fully implemented, while the rest were in the process or were not addressed at all. This level of implementation was lower by 6% compared to the previous year; and
- Out of 73 BOs that had IAU, eight of them had not established the AC. Furthermore, out of 65 BOs where the AC was functional, we noticed that 20 of them had held less than four annual meetings<sup>30</sup>. ACs are not yet effective to fully support the work of IAUs.

Internal audits continue to remain focused on compliance, and less on handling of performance and systems.

Despite improvements in internal control system compared to the previous year, it is not satisfactory yet, so that they act as a preventative mechanism of errors and irregularities.

## 11.2 Managerial reporting, accountability and risk management

### Managerial reporting and accountability

In order to have good planning, good supervision of activities, and to ensure effective decision-making, the management needs to have regular reports. Accountability as a process is acceptance of responsibilities, holding persons accountable for their actions and disclosure of results in a transparent manner.

Although heads of Budget organisations have implemented a number of internal controls to ensure that systems are functioning properly, we have noticed that measures applied are deficient and ineffective and do not ensure an adequate and timely response towards operational problems identified.

From individual audits conducted in 91<sup>31</sup> organizations, in 65<sup>32</sup> of them the NAO has identified weaknesses in controls, which have resulted in the following findings:

<sup>29</sup> Municipalities: Zubin Potok, Mamusha, Mitrovica North, Partesh, Leposavic, Zvecan, Klllokot and Hani i Elezit

<sup>30</sup> According to the AI no. 11/2010 is foreseen that AC shall hold at least four meetings a year.

<sup>31</sup> 30 independent institutions, 38 municipalities, and 23 central level organizations

<sup>32</sup> 18 independent institutions, 36 municipalities and 11 central level organizations

Our review of management controls at independent institutions has identified weaknesses and weak controls on wages and salaries, assets management, goods and services and utilities.

In central level institutions and municipalities, have been identified ineffective controls in the area of capital investments, asset management, liabilities, revenues and accounts receivable. Due to lack of controls, there is a large number of payments executed through court decisions, and by the Treasury due to delays by organizations in meeting liabilities.

In addition, the current format of management reporting does not provide a basis for effective internal controls, as written reporting to senior management is mostly done on request and not on a regular basis.

### **Risk Management**

Risk management is a process that has to do with identifying, analysing, evaluating, and actions/management measures to control and respond to threats that threaten the organization.

Individual audits have revealed the fact that out of 91 organizations, 38 of them or 42% have not drafted a risks register as required under the FMC. Whiles, practical actions in controlling, reducing and preventing risks were limited. Organizations do not update measures and monitor risks as required under the FMC procedures. This makes it impossible for the management to have a proper response to timely address operational, financial, administrative, and other risks that threaten organizational objectives.

#### **We recommend the Government and the Ministry of Finance to ensure that:**

- Upon requests by BOs, to review budget possibilities and allocate necessary funds for establishment of IAUs in Organisations that have not established these units yet;
- Public sector entities that have established IAUs, also establish Audit Committees in order to support and strengthen the internal audit function, while ACs should be more effective in their work and contribute to increased financial accountability; and
- Managements of Organisations that have not drafted a risks register should meet this requirement of the FMC to put under control threats exposed, and to carry out regular monitoring processes.

## 12 Procurement

The public procurement system during 2017 has made a slight progress. The most significant progress in this area is the use of the electronic procurement platform, which during this year has been used by almost all contracting authorities.

The e-procurement platform has been particularly used by central government organizations, with the exception of the Ministry of Infrastructure, which has implemented it partially.

This platform was also implemented in 33 municipalities, while it was partially used in three<sup>33</sup> of them, while in two<sup>34</sup> others was not used at all. Regarding independent institutions, e-procurement was used for all contracts with value over €10,000. However, for values from €1,000 up to €10,000 was used in only six of them, while seven institutions had not used the e-procurement system for small values. It is worth mentioning that for 16 Independent Institutions, public procurement procedures have been carried out by the Central Procurement Agency (CPA), as foreseen under the PPL.

Individual Regularity Audit Reports this year also highlight a number of weaknesses in procurement procedures, starting from planning, development of procedures, and management of contracts.

During this year, public entities have signed 10,214 contracts, worth around 460 million euros. Therefore, carrying out an effective procurement process is very important for development of the local economy.

### **The role of organizations responsible for public procurement**

Key entities for development and implementation of the Public Procurement System in Kosovo are the Public Procurement Regulatory Commission (PPRC), Procurement Review Body (PRB) and the Central Procurement Agency (CPA), while budget organisations have the role of the Contracting Authorities.

### **Public Procurement Regulatory Commission**

Public Procurement Regulatory Commission is an independent agency and is responsible for development, functioning and oversight of the public procurement system in Kosovo.

During the year, PPRC had issued two new regulations and had published nine legal interpretations with which the number of interpretations published on the PPRC's website reaches 57. In addition to this, the PPRC has a help desk that serves the CAs to clarify uncertainties of the process, which had provided interpretations on 2,666 issues raised by the contracting authorities.

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<sup>33</sup> Gjakova, Deqan, Junik

<sup>34</sup> Leposaviq, Mitrovica North

In the area of monitoring, PPRC had monitored 9,959 procurement documents of CAs and found 161 errors that had been requested to be corrected before they were published.

PPRC has also organized various trainings for procurement officers. One of the trainings was training for basic procurement professional certificate for the central and local level. The same training was organized for the staff of PPRC, CPA and PRB.

PPRC had organized and held two-day training for Electronic Procurement for 230 participants from CAs. Training for this area was also organized for internal auditors of public institutions, external auditors, investigators, committees for bid opening and evaluation, and procurement officers who had not been able to attend in the previous training.

Given the number of trainings that the PPRC has organized and the number of participants in these trainings, responsible procurement officials should have been more professional and the number of requests for interpretation should have been declining, rather it is on the rise. In addition, the number of complaints by economic operators to the PRB has increased compared to a year before.

### Procurement Review Body

PRB is an independent body and is responsible for implementing procedures and reviewing procurement complaints. During the year, PRB has received 553 complaints for public procurement, for public-private partnerships and auctions, and compared to the previous year there is an increase in the number of complaints by around 15%.

Decisions of the PRB regarding the complaints are presented in the following table, where it is noticed that more than half of them or 281 cases have been returned for re-evaluation.

**Table 21- Decisions of the PRB related to complaints for 2017**

Decision of the PRB	Number of complaints	Percentage compared to the total
Approval of the CA decision	161	29%
Re-evaluation	281	51%
Re-tender	41	7%
Withdrawal of complaint	16	3%
Dismissed	26	5%
Decision for implementation of decision	18	3%
Postponement of bid deadline	9	2%
Fines	1	0%
<b>Total</b>	<b>553</b>	<b>100</b>

Even in 2017, as in previous years, the most frequent violations against CAs towards which operators have filed complaints relate to: economy and efficiency, equal treatment/non-discrimination, means for promotion of transparency, tender dossier, technical specifications, examinations, evaluation and comparison of tenders, and the award criteria. Complaints are addressed towards 93 different CAs, which involve Central Institutions, Municipalities, Independent Institutions and Public Enterprises. The increase of complaints compared to the previous year was 24%.

Operators in certain cases had not adhered to the decisions of the PRB, as a result PRB during the year had issued four fines against disregarding operators: Telecom of Kosovo €25,000, Municipality of Gjilan €10,000 and two fines of €5,000 for the Municipality of Dragash and Prizren.

Collection of revenue from fines has been a challenge for the PRB every year, but different from previous years, this year the PRB had engaged enforcement agents and is awaited the decision of the respective Courts. The fine should have been a form of preventing irregularities during the implementation of public procurement procedures by the CAs, with the intention that the number of complaints filed against them decreases in the following years. However, this measure apparently has not achieved the desired effect given the upward trend of complaints.

### **Central Procurement Agency**

Central Procurement Agency (CPA) is an executive agency within the MoF, competencies of which are to: perform specific procurement activities on behalf of Contracting Authorities, following a decision of the MoF, carry out centralized procurements for common use items based on MoF's proposal and approval by the Government, carry out procurements according to the request of the CA, and assisting CAs during the implementation of procurement activities, at the request of the latter.

During this year the CPA had developed three centralized procurement procedures that resulted in Total 19 contracts. With the recent ones, the total number of centralized contracts under implementation had reached 35 for 14 types of common use items. Users of these contracts are central level institutions, municipalities as well as Kosovo's independent institutions.

Eight of these contracts have been audited by the NAO in an audit on value for money, and the audit results have been presented in a separate report, published earlier.

CPA had concluded 83 contracts for different contracting authorities, at their request, mainly for independent agencies.

## 12.1 Regularity issues in the area of procurement

Individual audit reports reveal that the procurement process is accompanied by shortcomings at all stages, starting from planning, development of procedures and up to poor management of contracts. Many issues identified are shortcomings that are repeated for years in audit reports.

The following table presents main issues encountered in the area of procurement, wither at central level institutions or municipalities.

**Table 22 - Regularity issues in the area of procurement**

Issue	Impact	Actions required by budget organisations
Widespread phenomena of annex contracts and activities outside the procurement plan.	Poor assessment of needs and incorrect specification of works and services results in late implementation of projects and potential budget damage.	BOs need to carry out more detailed analysis on needs before finalizing the procurement plan, in order to avoid as much as possible the phenomena of annex contracts
Initiating procedures without implementation plans, bills of quantities of construction contracts.	Signing contracts without an implementation project poses an increased risk of receiving poor quality works or poor value for money.	Adequate actions should be taken to ensure that drafting of projects is done before the initiation of tender procedures and start of works.
Entering into contractual obligations without prior commitment of funds or insufficient commitment of funds.	Entering into liabilities without the necessary funds can result in long delays in execution of contracts.	BOs should abandon the practices of entering into contractual obligations if they have not beforehand committed sufficient funds.
Poor processes of bid evaluation and awarding contracts to ineligible operators.	Awarding contract to ineligible bidder or with higher price is in disagreement with PPL requirements and can damage the budget of the organization.	Procurement managers should ensure that the bid evaluation process is in full compliance with established criteria.
Avoiding open procedures and frequent application of procedures with minimal value for same purchase.	Entering into many contracts for same purchases poses an increased risk where contracted prices may be higher than market prices.	Planning process should be accompanied by sufficient analysis on the real needs and should be ensured that are developed open procurement procedures.

<p>Inadequate segregation of duties of the evaluation committee and changes in the bill of quantities, and extension of deadlines without adequate approvals.</p>	<p>Inadequate segregation of duties threatens the objectivity of the evaluation committee, while changes to the bill of quantities may increase the cost of projects.</p>	<p>Effective controls should be established over the implementation of procurement procedures, and applied measures for proper segregation of duties in accordance with applicable legal framework</p>
<p>Contracting with higher value than the value estimated in the budget framework.</p>	<p>Contracting projects with higher values than the budget available causes financial difficulties and creates opportunities for lawsuits in cases of non-payment.</p>	<p>Responsible managers should strictly ensure that contractual obligations are in line with the budget available.</p>
<p>Shortcomings in defining criteria and evaluation of bids.</p>	<p>Due to unclear specification of the criteria during the evaluation in the same project, the same criterion was treated differently. As a consequence, there have been cancellations or delays in entering into contracts.</p>	<p>Procurement Managers, prior to the announcement of tender should ensure that project requirements and criteria are correctly defined in order to eliminate ambiguity and wrong interpretations.</p>
<p>Exceeding the deadline for evaluation of bids.</p>	<p>Due to delays in evaluation of bids increase the risk of manipulations and tender fixing.</p>	<p>Procurement managers should ensure that bids are evaluated within the legal deadline.</p>
<p>Validity of performance security shorter than the timeframe stipulated in the contract, or in smaller value.</p>	<p>A performance security that is shorter than the timeframe of the contract and with smaller value prevents potential measures against EOs when contracts are not fulfilled.</p>	<p>Responsible managers should ensure that contracts are not to be signed if the performance security does not cover the timeframe and the value, in order to ensure that delivery of works, goods or services is done in accordance with contracts.</p>
<p>Not assigning contract managers, lack of plans for management of contracts, and poor management of contract.</p>	<p>Shortcomings in the process of contract management make it impossible to evaluate how the contract is being implemented, and do not provide assurance that contracts are implemented in accordance with foreseen conditions and specifications.</p>	<p>The respective management upon entering into a contract should appoint a person that is going to be responsible for its management, who after the completion of the project should prepare a detailed report on contract execution.</p>

Supplies outside technical specifications, paying for supplies after the deadline foreseen in the contract, payments exceeded in the framework contract, and extending the framework contract for more than 36 months.	Obtaining supplies outside technical specifications, payment without valid contract, exceeding the contract value, and extending the framework contract for more than 36 months are in disagreement with law and regulations and can harm the budget.	BOs need to make a rigorous review to ensure that all supplies are obtained in full compliance with legal rules and procedures, and any payment should be based on a valid contract, and each contract duration is in accordance with the law.
Delays in supply, execution of works by EOs and implementation of capital projects, and failure to apply penalties for delays.	Failure to implement contracts on time has impact on fulfilment of objectives and operations of BOs. Failure to apply penalties damages the budget.	Budget spenders should carry out a review of the process and take necessary measures for better management and apply penalties for delays in accordance with the law.
Payments for incomplete works and without sufficient evidence.	Carrying out payments without receiving works and carrying out payments without evidence poses an increased risk as payments may be carried out for works that may never be completed.	BOs should strengthen internal controls and ensure that no payments are carried out before works are completed and necessary evidence has been received.

**We recommend the Government of Kosovo and the Ministry of Finance to ensure that:**

- The e-procurement platform is fully implemented by all Budget Organisations and in all procurement procedures even the small value ones; and
- The CPA has improved procurement practices in centralised contracts.

## 13 Developments in public administration reform

Public Administration Reform (PAR) is a complex and comprehensive process that aims at increasing the efficiency in development of the public administration, implementation of government policies, economic development, and improvement of services to citizens and businesses.

The Council of Ministers for Public Administration Reform (CMPAR) is the main responsible structure at the political level for the strategic direction of the reform process, monitoring of its implementation and serves as a forum of discussion and analysis of the progress and challenges, and proposes changes needed for future reforms. Meanwhile, the Ministry of Public Administration is responsible for the overall coordination of PAR and monitors its implementation.

The management of the strategic package of PAR is organized in three pillars: (1) Development and coordination of policies and legislation - under the responsibility of the Office of the Prime Minister; (2) Civil service, management of human resources, public administrative services and reorganisation and accountability - under the responsibility of the Ministry of Public Administration; and (3) Public Financial Management - under the responsibility of the Ministry of Finance.

In general, the Strategy for Modernisation of Public Administration is being implemented at a slow pace. During 2017, out of 51 activities: 14 were implemented, 29 are under implementation, while 8 activities were not implemented. During 2018 is expected:

- Approval of the legal package that contains the law on civil service, salaries and the organization and functioning of the public administration;
- Starting of implementation of the action plan to rationalise (half) independent agencies and bodies<sup>35</sup>;
- Improvement of legal predictability for citizens and businesses<sup>36</sup>.

Regarding the first point, the MPA has accelerated its actions in order to process the legal package in July 2018 to the Government and the Assembly, and has drafted an action plan for 7 to 9 independent agencies to be integrated within the government structures.

In order to provide quality services to citizens, the Interoperability Platform (Government Gateway) was developed in 2017 established in the infrastructure of Information Society Agency (ISA-MPA). In June 2017, a contract between the MPA and Microsoft Company was signed, where were configured and integrated systems: Civil Registry, Property Tax System, Address Registry System and the Notary System. During 2018, 10 platforms are expected to be integrated into the Platform.

<sup>35</sup> According to the agreement between the Assembly and the Government

<sup>36</sup> By gradually amending and supplementing special laws identified and implementing acts that are in disagreement with the new Law on General Administrative Procedure.

In addition, the E-box project has also been functionalised in 35 Budget Organisations, 12 ministries, 7 municipalities, 14 agencies, Customs, and Tax Administration. For 2017, the level of satisfaction of citizens with services at these institutions is at 62%, on average 9% are satisfied and 29% dissatisfied.

Implementation of strategies and objectives is developing slowly. Therefore, up to the approval/functionalization of the legal package and rationalization of agencies, concerns remain regarding the recruitments not based on merit that affect efficiency and professional independence of public administration, as well as the salary differences for equivalent work. In addition, the lack of communication/full link of the HRMIS with the Payroll System, as well as integration/entry of personal/employment data of civil servants from physical files to electronic form into the HRMIS continues to remain challenging. So far, out of all institutions, approximately 60% of the data of civil servants has been completed. In addition, lack of regulations for a trainer at KIPA shows weaknesses in increasing the quality of public administration etc.

In the area of Public Financial Management, the Reform Coordination Group for 2017 has reported progress in many areas, among them the fiscal discipline. However, the annual implementation report shows partial implementation and highlights some areas that require more attention. Progress is needed in terms of departing between the approved budget and implementation, high number of budget transfers, percentage of implementation in capital investments, implementation of NAO and IA recommendations, etc.

### **Overall Conclusion**

Implementation of the strategic framework in general has been slow, mainly due to ambitious planning, lack of coordination of policies and lack of resources. Two of these strategies have been reviewed in 2017, while two are in the process of being reviewed in order to improve targets and indicators, and ensure more realistic planning and costing<sup>37</sup>.

We consider that the **Council of Ministers for Public Administration Reform** should analyse the causes and real reasons behind the setback in implementation of strategies, and take corrective and comprehensive actions in order to accelerate the reforms.

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<sup>37</sup> Report on Kosovo 2018, European Commission

## 14 Applicability of laws and legal challenges

The audit process has highlighted several issues related to application of laws and current challenges, which have been disclosed in the following:

### Issues raised by audits of central level organizations

**Discrepancy between the organic law and the law on state administration** - Organic laws regulating the activity of MCYS institutions in many cases are in disagreement with general laws based on which the Ministry should function. Directors of these institutions report to the Department of Culture even though the Law on State Administration, Regulation on Standards of Organization of State Administration and the Regulation on Internal Organization and Systematization of Job Positions in the MCYS clearly define the only organizational units that may be under subordination of departments are similar divisions.

In addition, cultural heritage institutions are not regulated by specific organic laws and report to the Department of Cultural Heritage at MCYS. Their activity is based on the Law on Cultural Heritage, except for the Kosovo Museum, which is based on the Law on Cultural Institutions. Under this arrangement, these institutions are not entitled to have budget codes and manage their budget, but these should be carried out by the Ministry. Meanwhile, we have noticed that these institutions incur expenditures in disagreement with existing legal regulation.

**Keeping of mandates by diplomatic representatives after the expiration of legal mandate** - According to the Article 22 of the Law on Foreign Service of the Republic of Kosovo, diplomatic representatives stay in service on the same diplomatic mission for a period of four years, or as required to meet the needs of the Ministry and at the discretion of the Minister of Foreign Affairs.

We have noticed that in six cases diplomatic representatives had continued holding same positions after the expiration of the legal mandate, although there was no decision or a letter to extend the mandate. From these, in three cases there were no decrees for return, although the mandate of representatives had expired, in two cases where issued decrees for return, but representatives had not returned, and in one case was issued the decree for return and the decision to withdraw from the duty, but the ambassador was not re-systemised after the return and had received a salary according to the grade of the ambassador for a period of three months. This has occurred as a result of lack of secondary legislation or adequate procedures on ending of mandate and re-systemisation of diplomatic representatives.

**Payment of salaries from inadequate categories** - The MDSI for Directors of three Kosovo Cultural Centres in Diaspora and Migration (KCCDM) had paid on behalf of salaries the amount of €65,849 from goods and services, which should have been paid from wages and salaries. This has happened because these directors were not selected under public competition and in line with civil service rules, as required under the Law on Diaspora and Migration, as well as the Regulation on election of the Director of KCCDM. Since the establishment of KCCDMs (in 2013 in Turkey, and 2014 in Switzerland and Sweden), directors have been engaged based on decisions as Acting Duty and without being subject to recruitment procedures.

**We recommend the Government of Kosovo and the MCYS to:**

Initiate procedures for aligning organic legislation of cultural institutions with the general legislation on organization of administration and for management of public finances. In addition, managing and spending of the budget of cultural heritage institutions should be done by respective departments in the Ministry.

**We recommend the Government of Kosovo and the MFA to:**

Initiate a review of the secondary legislation related to external service in order to clearly specify the procedure for ending of mandate of diplomatic representatives, including necessary timeframes and matters that are relevant for withdrawal and re-systematisation of diplomatic staff. In cases when there is a need to extend the mandate of particular diplomatic representatives, it should be done based on Minister's decision or letter, in accordance with the Law on Foreign Service.

**We recommend the Government of Kosovo and the Ministry of Diaspora to:**

Take actions towards recruiting directors of KCCDMs within a reasonable timeframe, in accordance with legal requirements, so that they are included in the payroll and paid from adequate expenditure category.

## Issues raised by audits of public enterprises

**Operating with expired licence** – Kosovo Landfill Management Company (KLMC) manages Waste Landfills in around 70% of Kosovo's territory. Law on Waste no. 04/L-60 (Article 16, point 1) requires to "Collect, gather, shipment, treat, elaborate, recycle and deposit the wastes perform only licensed person". Despite the efforts to secure the license (and our recommendation from the previous year), the company still continues to operate with a temporary license from 2012 due to non-response by the Ministry of Environment and Spatial Planning.

**Lack of a document on fees for waste disposal** - Law on Waste no. 04/L-60, Article 14, point 2, stipulates "According to the provisions of the Law on Public Enterprises and this law, the Ministry of Economic Development, in accordance with the relevant municipalities set out the fees for the disposal of municipal waste in landfills designated".

KLMC had failed to secure the fee according to this request and continues to charge its services based on fees inherited from WWRO<sup>38</sup> in 2012. This fees document (expired) covers only the collection of household waste worth €5.31/ton. The company continues to accept other types of waste for which there was no license or fees document, such as: disposal of glass, rubber, soil and stone waste, animal waste and disposal of customs waste. For these types of waste, the Board of Directors of the Company in January 2016 had set a fee in the amount of €50/ton. The company took this action due to lack of response by the competent fees setting authority, namely the MED.

<sup>38</sup> WWRO – Water Waste Regulatory Office.

**Lack of regulations on management of non-current assets** - Statutes of public enterprises KLMC, RWC "Hidroregjioni Jugor", Bus Station J.S.C Prishtina, and Regional Water Company Drini i Bardhë J.S.C, specify the request for these POEs to draft regulations that contain provisions for administration and functioning of the society. We have noticed that these companies have not had regulations on management of non-current assets, which should be adapted to the needs and requirements of the enterprise, by relying on applicable standards and rules.

**Failure to extend employment contracts on time for a number of managers in Enterprise RWC Prishtina J.S.C** - According to articles 10 and 11 of Law on Labour no. 03/L-212, employment contract is concluded in writing and signed by the employer and the employee. Nine (9) managers had expired contracts at the end of December 2016, but the same had continued to work and be paid throughout 2017 without a formal extension of these contracts. Their contracts were extended from 01.01.2018. According to the payroll list paid for 2017, these managers had received salaries in the amount of €114,525.

**Failure to draft the code of ethics as required by law** - According to article 35 of Law no. 03/L-087 for POEs, all POEs should prepare, approve and implement a mandatory Code of Ethics and Corporate Governance. The Code of Ethics and Corporate Governance which obliges POE for the implementation of highest standards of conduct and business practices, should be detailed in order to offer clear guidance on the behaviour of directors, officers, employees and professional consultants of POE, and to create a program for the protection of persons who reveal to the public facts around misuses within the Company. RWC Prishtina had a code of ethics approved in 2006 which was not up-to-date and tailored according to the requirements of the POE law and the Model of the Code of Ethics and Corporate Governance of POEs that MED has modelled to assist POEs in drafting their own Code of Ethics.

**Continuation of work after contract expiration by a number of staff of Hortikultura J.S.C** - According to the Labour Law, contracts with certain deadlines have a determined period of employment. During our testing, we noticed that contracts of four Senior Officials of the Enterprise: Chief Executive Officer, Chief Financial Officer and Treasury, Corporate Secretary and Internal Auditor have expired as of 2015, while they were working with expired contracts. Failure to renew the contracts of these officials occurred due to the absence of the Board of Directors.

Furthermore, the Procurement Officer was without a contract of employment since 2010, and there is only a decision which has no deadlines. In addition, in the decision it is stated that this decision is a base for contract conclusion, but the act of establishing the contractual agreement has not taken place.

**Failure to draft a document on fees for invoicing of services** - According to the Law no. 02/L-9 on Agricultural Land Irrigation, Article 8, fees that should be paid by associations and farmers shall be determined by the Supervisory Board of the respective company. RWC Drini i Bardhë J.S.C had not issued a fees document where fees would be set for provision of services. However, the BoD had issued decisions for setting of fees based on Article 31.3 of the Law on POEs, and based on Article 14 point 2.1.11 of the company charter. However, these Articles regulate the manner of annual and quarterly reporting and not the manner of setting fees.

**Failure to renew the permit for the Regional Water Company Drini i Bardhe J.S.C** - Drini i Bardhe failed to secure the Water Permit, in accordance with the requirements of the Law on Waters in Kosovo no. 04/L-147 (Article 71, point 1). Despite its efforts to secure it, as of August 2014, Drini i Bardhë continues to work without water permit, because the competent body (Ministry of Environment and Spatial Planning) has rejected the request as incomplete.

**Recommendations for the Government**

- The Government should consider the issue of operating of publicly owned enterprises, KLMC and RWC “Drini i Bardhë” without work licenses and in cooperation with MESP and Steering Boards of these two Enterprises equip these two enterprises with valid work licenses within a reasonable time; and
- In cooperation with the MED, solve the problem of setting fees for collection and disposal of waste for the needs of KLMC.

## 15 Performance Audits

In order to promote standards for transparency and accountability in the management of government activities and programs and the performance of public administration, the National Audit Office has given special focus to performance audits. The aim with these audits is to improve operations and government activities, and provision of reliable information to the Assembly of Kosovo on how the Government has spent public money.

In order to achieve this goal, the NAO has covered areas that are of interest to the Government, Parliament and taxpayers in general. INTOSAI standards, based on 3 Es<sup>39</sup> were taken as a reference for the approach applied in performance audits.

Performance audits for the audit season 2017/18 have highlighted that:

- The judicial system continues to face a considerable number of unsolved cases for many years, while the number of civil cases is constantly increasing. Furthermore, the Kosovo Judicial Council was not efficient in monitoring the progress achieved by Courts;
- Engagement of employees with special services agreements besides being in disagreement with applicable laws, does not even serve the achievement of institutional objectives;
- Air pollution in Kosovo is concerning as it threatens the health of citizens, while citizens are not informed on time and how to behave towards this problem;
- Centralized procurements do not provide value for money. The Government of Kosovo risks paying 2.6m euros for goods that were contracted but were not received;
- The property tax information system is not very effective in processing data on property tax. Shortcomings in the governance and application of information technology are two of the main causes;
- The Health Information System in Kosovo has started being implemented only partially in some health organizations. Government's objective of 2014 for implement this system in 30% of the country's territory has not been achieved, until May 2017; and
- The e-assets software application has not achieved its primary goal, to create a unified central base for effective management of public assets.

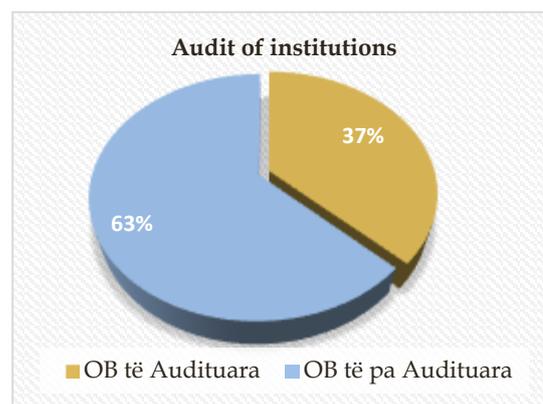
In the following was presented an analysis over the audit of budget organisations and coverage with performance audits.

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<sup>39</sup> Economy - reducing the cost of resources used for an activity, bearing in mind the right quality;  
 Efficiency, the relation between outputs in terms of goods, services, outcomes and resources used to produce them; and  
 Effectiveness, the extent objectives have been achieved to and the relation between the intended and actual impact of an activity.

**Table 23. Coverage of performance audits**

Institutions - BOs		Audited	%
Central level	25	12	48
Local level	38	15	39
Independent institutions	30	12	40
Central Publicly Owned Enterprises	18	2	11
<b>Total</b>	<b>111</b>	<b>41</b>	<b>37%</b>

**Graph 2. Total of audited BOs**

The Graph shows that out of total 111 BOs of the central, local, independent institutions, and public enterprises, we have covered 41 or 37% of them with performance audits in different areas. In the following have been summarized nine (9) performance audit reports.<sup>40</sup>

#### (a) Procedures and controls in the system for management of municipal performance

In 2009, the Ministry of Local Government Administration has started implementing the Municipal Performance Management System which has addressed the performance of municipalities in the areas of own competences.

**Audit message** - The Ministry of Local Government Administration had not created all necessary preconditions for the functioning of the Municipal Performance Management System. Municipalities had difficulties in applying procedures and controls foreseen under the system. Data collection procedures were deficient, there were problems with reporting, and verification of data and provision of access to data by municipal units was difficult. As a result, some of the reported data was not supported, or as was defined under the methodology. From analysis of documents used by municipal officials to report indicators in the six audited municipalities has resulted that only 51% of indicators are supported with documents. These shortcomings make us conclude that MPMS is not fully effective and reliable.

#### (b) Efficiency in civil case management within basic courts

One of the issues faced by the judicial system in Kosovo is the slow and inefficient management of court cases. A proper management of cases improves their recording and processing, reduces delays in handling cases, reduces the burden of court cases and provides information to support the strategic allocation of time and resources.<sup>41</sup>

<sup>40</sup> Individual reports can be found at: <http://www.zka-rks.org/publications/>

<sup>41</sup> World Bank - Doing Business (2016), Enforcing contracts - Measuring good practices in the judiciary

**Audit message** - The Basic Courts of Pristina, Peja and Gjilan are not sufficiently efficient in management of civil cases. Courts continue to face a considerable number of old cases that remain unsolved, as well as the overall number of civil cases, which is constantly increasing. In 2015, Basic Court in Prishtina had 2948 unsolved cases, while in 2016 this number was 3304, or 12% higher than in the previous year. There were also an increase in the number of unsolved cases in the other two courts, namely around 28% in the Basic Court in Peja, and around 7% in the Basic Court in Gjilan. As a result of the large number of civil cases in Basic Courts, citizens are forced to wait for long period of time before their case is examined.

Irregularities have been evident since the initial phase of distributing civil cases to judges, the completion and clarifying the lawsuits, inadequate management of cases by legal secretaries, constant postponement of court sessions, delays in adjudicating cases by the Court of Appeals, as well as the high rate of cases returned for re-trial in Basic Courts.

The Kosovo Judicial Council has not been effective in properly monitoring the progress achieved in Courts. Generalised mechanisms of the Kosovo Judicial Council make it difficult to monitor the progress achieved in Courts, and are not the right tools to address irregularities encountered upon management of court cases.

### **(c) Special services agreements and employment contracts for specific tasks**

The purpose of entering into Special Services Agreements and Employment Contracts for Specific Tasks is to engage other persons for temporary tasks, which cannot be carried out by regular employees. This includes the work of certain experts, occasional tasks requiring special technical knowledge, work in providing educational and training services, etc.

**Audit message** - The Ministry of Public Administration had not drafted secondary legislation and clear procedures for this type of engagement through which the terms and conditions of engagement would be determined. On the other hand, audited Ministries<sup>42</sup> and Municipalities<sup>43</sup> had engaged employees with these agreements/contracts without any proper planning and formal monitoring of their performance. Reporting was not complete and accurate, as well as financial costs have increased compared to the previous year.

Engagement of employees with agreements/contracts has increased in 2016 compared to 2015, whereby have increased financial costs of these agreements. At the central level in 2016, expenditures for this type of engagement had increased by 55% compared to 2015, while at the local level they had increased by 76%.

<sup>42</sup> Ministry of Culture, Youth and Sports, Ministry of Environment and Spatial Planning, Ministry of Agriculture, Forestry and Rural Development and the Ministry of Infrastructure.

<sup>43</sup> Ferizaj, Peja, Gjilan, Prizren, Suhareka and Prishtinë.

#### **(d) Efficiency and effectiveness in implementation of unified and integrated health information system**

Accurate and timely information on the health status of country's population has impact on making the right decisions regarding necessary improvements to provide health services and to lead a Health Institution efficiently. To achieve this, the Ministry of Health (MoH) has drafted and approved the strategy for the Health Information System (HIS) in Kosovo (2010 -2020). For implementation of the strategy was planned €15.9million.

**Audit message** - The MoH has not managed to functionalise the HIS as was foreseen under the strategy. The objective to extend this system to 30% of the country's territory planned for 2014 was not achieved by May 2017. Only 39% of patients from five audited institutions were recorded in the HIS, because the system was not applied in all wards planned for the pilot stage. Failure to implement the HIS, among other, has had impact on the development and implementation of the Information System of Health Insurance Fund. There was a lack of coordination and planning of activities within the MoH and the institutions involved in the implementation of the Health Information System. The National Council for the HIS foreseen to be established in 2011 was established in 2015, namely, with a four year delay. Due to this, all activities foreseen under the Action Plan were carried out with a delay. By the end of 2016, for the purpose of this project were spent only 6.5 million euros or 47% of the budget.

#### **(e) Management of co-financing agreements with donors and results achieved"**

External financial support in Kosovo has been executed through some forms of cooperation. One of the most important forms for execution of development projects is conclusion of co-financing agreements with external donors.

**Audit message** - The Government of Kosovo had not managed to put in place sustainable mechanisms that would assist in coordinating, monitoring and reporting on co-financing. Access and traceability of government information on co-financing to the final beneficiary is quite difficult. The government does not have full information on how much is the financial value of external aid, how much is the funding from Kosovo institutions, what sectors are financed, and what is the progress of co-financing.

Mechanisms established by the Ministry of European Integration are not fully effective to ensure smooth execution of processes starting from planning, coordination for financing of projects, as well as their monitoring. Ministries, Municipalities and Publicly Owned Enterprises as beneficiaries of projects have not managed to implement projects at a satisfactory level and achieve goals for which funds have were given.

#### **(f) Effectiveness within the Property Tax Information System**

The Property Tax Information System (PTIS) currently applicable in Kosovo is used for the purpose of processing, calculating and maintaining the property tax data. PTIS was developed by the Ministry of Finance (MoF) with the support of the Swedish Tax Agency and financed by the

Swedish International Development Cooperation Agency as support to the system, by having an impact on the increase of property tax revenues from 2010 to 2016 by 86%.

**Audit message** - MoF has not managed to ensure full effectiveness of the PTIS. Regardless of system complexity, inherited problems from earlier versions and records, as well as different limitations in securing capacities, the system has a good basis and sufficient information. Although it is planned that the project is finalised by December 2017, the Ministry of Finance has not yet managed to meet the Terms of the Agreement, by risking the termination of the project itself. Transferring of responsibilities to the Ministry of Finance has not yet started as foreseen in the transition phase of the project, by putting the functioning and sustainability of the system into question.

The system does not possess adequate mechanisms or tools to identify or handle entry of invalid data. Controls of quality and accuracy are not effective. In addition, it does not contain traces of changes and was not conducted measuring of system effectiveness. This makes planning of necessary capacities for proper operation in the future impossible.

#### **(g) Management and use of e-assets application**

E-assets application was launched in 2010 to enable public institutions to have data at all times on the status of their assets.

**Audit message** - The Ministry of Public Administration, namely the Information Society Agency has not ensured adequate functionality for proper operation of e-assets application. Although nearly one million Euros have been invested by the Government for development and maintenance of the application, the primary goal for establishing a unified central base for effective management of public assets has not been achieved.

The level of use is different in six (6) Budget organisations that were selected as a sample of this audit. Kosovo Customs does not use the e-assets application at all, while the Ministry of Culture, Youth and Sports and the Municipality of Ferizaj have a limited use of this application. A better situation was noticed in the Ministry of Internal Affairs, Privatisation Agency of Kosovo and the Municipality of Lipjan.

By verifying the list of users of this application, we have found that more than 800 users are unidentifiable, accounts of which in the application have been created with different names that do not comply with application's requirements and purpose. In addition, in the full list of officials that use the e-assets application, we have noticed that on average, 2000 users have more than one created account.

#### **(h) Value for Money in Centralised Procurements**

Expenditures through public procurement are constantly increasing. In the last four years, through procurement, an average of 497 million euros<sup>44</sup> was spent.

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<sup>44</sup><https://krpp.rksgov.net/krpp/PageFiles/File/Raportet%20Vjetore/2016/Raporti%20vjetor%202015%20Shqip.pdf>, page 21

CPA during 2016 signed contracts that amounted to 44 million euros. The centralized procurement objective is to make economic purchases. Centralised procurement involves large quantity purchases therefore the price obtained through centralised procurement should be lower than or at least the same as the lowest price that each CA received through individual procurement.

**Audit message** - CPA had not managed to conduct efficient and economic procurements through centralized procedures, which would result in budget savings. Issues that have hindered fulfilment of these objectives have to do with important shortcomings in implementation of centralized procedures. Due to inadequate analysis of (individual) contracts of Contracting Authorities and lack of any form of market research resulted in contracting more expensive prices than those available in the market. Another shortcoming in this process was ineffective collection of data by contracting authorities, which resulted in poor planning and poor execution of contracts. As a consequence of the poor execution, i.e. not reaching the threshold of 70% of the contracted value, the Budget of Kosovo risks to suffer a loss of 2.6m euros. These shortcomings pose potential risks for not achieving value for money while a final assessment will be made through a separate audit report after these contracts are finalised.

Shortcomings were also in the process of monitoring over the implementation of contracts due to lack of their follow-up. Furthermore, in most contracts were not specified obligations and rights of each Contracting Authority and consequently there was lack of remedial measures regarding the inadequate/excessive use of some contracts by Contracting Authorities.

#### **(j) Institutional Mechanisms for Legal Arrangement, Monitoring and Reporting of Air Quality**

Air pollution is a very important environmental and social issue and at the same time is a complex problem that presents many challenges in terms of management and reduction of harmful pollutants.

**Audit message** - The Ministry of Environment and Spatial Planning has not established all necessary legal prerequisites to regulate the air quality in Kosovo, and has not updated the entire necessary legal framework according to the current condition of the air quality in the country. Such a framework does not serve as a guidance that facilitates the work of institutions to take specific measures on improvement of air quality.

Current system for monitoring and reporting of air quality data has resulted being deficient as it is characterized by many irregularities. Only 17% of monitoring stations have been operational for the most part during 2017, while 33% of stations have been out of service for more than 7 months during the year. Furthermore, these stations were relocated several times, reporting was irregular and incomplete, security and constant monitoring of monitoring stations is missing, and is also missing the central system for collection and processing of data.

Even though there were improvements in reporting of the situation from 2016 to 2017, hazardous parameters to human health that are evident in our country, PM<sub>10</sub> and PM<sub>2.5</sub> (dust particles) have not been reported on average 4.2 months during 2017. This is particularly important during winter months where these parameters reach maximum values. Despite the deficient monitoring and

reporting, in those cases when reported, the values of the parameter PM<sub>10</sub> recorded were alarming and were exceeded by up to 400%.

**We recommend the Assembly of Kosovo to:**

- Increase accountability towards the Kosovo Judicial Council to ensure that Basic Courts have increased their efficiency in handling and managing civil cases in accordance with applicable procedures and rules;
- Review the existing legal framework for improvement of air quality and propose legal initiatives for functionalization of monitoring network and measures to prevent air pollution; and
- Through the parliamentary committee for health, to initiate discussions on challenges that hinder application of the HIS and propose measures for its implementation on all health institutions.

**We recommend the Government to ensure that:**

- In cooperation with the Ministry of Finance to analyse the centralized procurement process and ensure that procurements through the CPA meet needs of budget organisations on time and with right quality, and to achieve the value for money; and
- Engagement of employees for specific services agreements and specific tasks is done in full compliance with legal framework and only for works and tasks that require special expertise needed in the public sector.

**We recommend the Ministry of Finance to:**

Analyse all shortcomings and weaknesses within the Property Tax Information System and take necessary measures to make the system fully efficient and that generates complete data on all property tax payers.

## 16 Publicly Owned Enterprises

In addition to obligatory audits, during this season the NAO has also audited the Financial Statements of nine (9) Publicly Owned Enterprises. Seven of them were audited for the first time by the NAO.

The audit of AFS for 2017 has highlighted that the financial management and control system at POEs needs substantial improvements. The fact that to nine POEs were given modified opinions shows poor quality of reporting and operation of financial systems in POEs. All audited Financial Statements have resulted in inaccurate financial data, and consequently in material errors.

Almost all public enterprises are characterized by lack of strategic plans, managerial accountability, poor periodic reporting, inadequate segregation of duties, lack of regulations, and other shortcomings.

Existing budget planning processes are weak, as they do not contain sufficient analysis and do not take into account the risks that may occur and threaten objectives set by POEs. Some of POEs continue to operate with financial losses and the constant need for subsidies by the Kosovo Budget or donors indicate of fragile financial systems. Due to financial stability was impossible to establish adequate capacities to ensure more qualitative services to citizens.

In order to improve current management practices, a number of recommendations were given in individual audit reports for the Steering Boards of these enterprises.

### 16.1 Audit Opinions for Publicly Owned Enterprises

In the following table was given a view on opinions given for AFS for 2017.

**Table 24 - Audit Opinions given for publicly owned enterprises**

No.	Audited POEs	Audit opinion
1	RWC Prishtina J.S.C	Qualified
2	RWC "Hidroregjioni Jugor" J.S.C Prizren	Qualified
3	Bus Station J.S.C Prishtina	Qualified
4	KLMC J.S.C	Qualified with emphasis of matter
5	Hortikultura J.S.C Prishtina	Adverse
6	Kosovo Railways Trainkos J.S.C	Adverse
7	RWC Uniteti J.S.C Mitrovica	Disclaimer of Opinion
8	Gjakova Airport J.S.C	Disclaimer of Opinion
9	RWC Drini i Bardhë J.S.C	Disclaimer of Opinion

Irregularities identified during the audit that have caused the modification of the opinion relate to the following causes:

**Qualified Opinions** - are given due to lack of evaluation of non-current assets for more than five years, namely, since their transformation in 2007 when they were under the management of the Privatisation Agency of Kosovo, and the explanatory notes were not complete and accurate.

**Adverse opinions** - are given because the information on accounts receivable, payables, balance sheet, reserve capital, non-current assets has not been re-evaluated for more than 5 years, and explanatory notes were not complete and accurate (Hortikultura J.S.C and Kosovo Railways Trainkos J.S.C).

**Disclaimer of Opinion** - The NAO has refused to give an audit opinion for three POEs because it was not able to secure the necessary audit evidence. Due to limitations on obtaining the information and the inability to draw clear and based audit conclusions, we were unable to form an audit opinion. This has happened with: (1) RWC Uniteti J.S.C Mitrovica, (2) Gjakova Airport J.S.C and (3) Drini i Bardhë J.S.C Peja.

Lack of information was prevalent in non-current assets and their depreciation, short-term request, liabilities towards employee, deferred revenues, accounts receivable, carried forward earnings/losses, cash flow statement and statement of changes in equity, and explanatory notes had not provided complete and accurate information.

## 16.2 Previous Year's Recommendations

POEs that were audited by private auditing firms one year prior had resulted in a lower number of recommendations as the focus and methodology of their work was mainly focused on the part of financial reporting and less on compliance.

On the level of implementation of recommendations, see the table below.

**Table 25 – Implementation of audit Recommendations for 2016**

No.	Audited entities	Number of recommendations	Implemented	Under implementation	Un implemented
1	RWC Prishtina J.S.C	13	4	1	8
2	RWC “Hidroregjioni Jugor” J.S.C Prizren	2	0	1	1
3	Bus Station J.S.C Prishtina	5	2	1	2
4	KLMC J.S.C	16	6	8	2
5	Hortikultura J.S.C Prishtina	2	2	0	0
6	Kosovo Railways Trainkos J.S.C.	19	7	7	5
7	RWC Uniteti J.S.C Mitrovica	7	0	0	7
8	Gjakova Airport J.S.C	8	4	4	0
9	RWC Drini i Bardhë J.S.C Peja	11	0	3	8
	<b>Total of recommendations</b>	<b>83</b>	<b>25</b>	<b>25</b>	<b>33</b>

From the table above we see that: out of recommendations given in the previous year, 30% of them have been implemented, 30% of them are in the process of implementation and 40% of them have not yet been addressed. A low level of implementation of previous year’s recommendations is noticed especially in POEs that were audited for the first time by the NAO.

### 16.3 Procurements in Publicly Owned Enterprises

The procurement process at POEs should also be implemented according to the rules and procedures set out in the Public Procurement Law in Kosovo.

Audit results have shown that existing controls in the area of public procurement in publicly owned enterprises are accompanied by shortcomings during all stages. All issues raised in this area have been presented in detail in individual audit reports, but in a summarised form, we are also presenting them in following table.

Table 26 – Key issues that have been identified during the audit of POEs

Issue	Cause	Impact	Actions required from management
Identification of needs by requesting units for procurement planning was not based on proper analysis <b>(RWC Prishtina)</b>	Requesting units had not submitted requests for initiation of procurement procedures.	Signing of contracts that are not foreseen in the procurement plan reflect poor planning and ineffective implementation	To ensure that requesting units submit the requests in time allowing the Procurement Office to plan and initiate procurement activities and procedures in a timely manner.
Irregularities during the tender opening <b>(Horticulture)</b>	Failure to comply with the decision by the members of bid opening committee.	Lack of responsible officials in the opening committee and participation of the Procurement Officer in the committee without being appointed, causes non-compliance with the PPL.	To ensure that in the process of opening the tenders are involved persons responsible and appointed under a special decision.
Purchase of goods and services without procurement procedures. <b>(In most audited enterprises).</b>	Failure to apply controls over purchases.	Avoiding procurement procedures risks the budget, as is not achieved value for money.	Management should strictly prohibit the purchase of goods and services outside procurement procedures
Receiving report was not in line with the quantity invoiced <b>(Airport of Gjakova)</b>	Failure of certification controls.	Discrepancies between the number of items in the receiving report and those in the invoice pose a risk of carrying out payments for goods that are not received.	Management should strengthen certification controls so that payments are carried out only for received good/services.
Delays in executing projects - Construction of new factory in Shkabaj <b>(RWC Prishtina)</b>	Failure by the Ministry of Environment and Spatial Planning to finalise expropriations.	Failure to expropriate properties prior to commencement of works can cause delays, additional costs and increases the risk for the company to be subject to penalties for delays.	Management should ensure that all necessary expropriation procedures have been completed prior to signing contracts for execution of works.
Poor management of contracts. <b>(RWC Prishtina)</b>	Delays in implementation of contracts were as a result of poor management of contracts.	Due to inadequate management of contracts results in poor execution of contracts and in provision of poor quality services to consumers.	To ensure adequate management of contracts and in cases when EOs do not adhere to the contract conditions, penalties should be applied.

## 16.4 Analysis of the financial situation in Publicly Owned Enterprises

The following analysis outlines main indicators of the financial situation for six POEs of central level and three of the local level. Subject to this analysis were: revenues, expenditures, financial results, short-term and long-term liabilities.

**Table 27. Financial results and liabilities of POEs on 31.12.2017**

No	Audited entity	Revenues	Expenditures	Financial results	Short-term liabilities	Long-term liabilities
1	RWC Prishtina J.S.C	15,969,369	15,435,253	480,705	2,102,520	58,165,463
2	RWC "Hidroregjioni Jugor" J.S.C Prizren	5,425,470	5,394,976	30,494	3,726,718	9,659,690
3	Bus Station J.S.C Prishtina	1,012,338	1,237,250	(224,912)	93,219	0
4	KLMC J.S.C	2,206,514	1,995,823	187,348	487,674	1,593,336
5	Hortikultura J.S.C Prishtina	1,025,693	958,276	60,675	20,252	0
6	Kosovo Railways Trainkos J.S.C.	4,169,457	4,042,945	113,861	1,533,111	3,933,999
7	RWC Uniteti J.S.C Mitrovica	1,674,958	1,667,213	6,971	2,206,997	190,726
8	Gjakova Airport J.S.C	680,362	680,362	0	5,568	8,878,306
9	RWC Drini i Bardhë J.S.C Peja	381,973	320,898	61,075	100,877	2,608,652

Publicly Owned Enterprises have not presented accurate reporting of accounts in accounting records or in the AFS. Only one out of nine of them (Bus Station) presented a negative financial outcome at the end of the year, while other POEs have reported profits at the end of the year. However, according to the audit, due to material errors in the income statement, enterprises that have also operated with losses this year are: RC Trainkos J.S.C, RWC Uniteti J.S.C, and RWC Drini i Bardhë J.S.C.

The table above presents concerning figures on the financial stability of these POEs. They collectively have over 10 million short-term liabilities, and over 85 million long-term liabilities. The return of these liabilities is quite uncertain, given the fact that all of them are at the cost-benefit ceiling, and in real terms also operate with loss.

The Government provides substantial amounts of subsidies to cover operational deficits, and as long as these trends continue in these POEs, financial burden of the Government will only become greater. Furthermore, the principle of continuity of activity in some of them may be seriously questioned.

Our conclusions are that Steering Boards of POEs are not very committed to establish clear policies and strategies to overcome the unsound situation in their environments where they operate. Therefore, in such conditions, a more active involvement by the Government to solve problems is indispensable.

**We recommend the Government and the Ministry of Economic Development to ensure that:**

Immediate measures are taken to review the overall situation of these POEs. Steering Boards of these enterprises should play a key role in addressing main problems faced by enterprises, and then set out a set of measures and actions to be implemented in order to rectify the existing situation. In addition to management and operational issues, a subject to focal reviews should be short-term and long-term liabilities and the liquidity to meet the liabilities.



## ANNEXES



## Annex I: Explanation of the different types of opinion applied by NAO

(extract from ISSAI 200)

### Form of opinion

147. The auditor should express **an unmodified opinion** if it is concluded that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework.

If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with the section on "Determining the type of modification to the auditor's opinion".

148. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor should discuss the matter with the management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the audit opinion.

### Modifications to the opinion in the auditor's report

151. The auditor should modify the opinion in the auditor's report if it is concluded that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or if the auditor was unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. Auditors may issue three types of modified opinions: a qualified opinion, an adverse opinion and a disclaimer of opinion.

### Determining the type of modification to the auditor's opinion

152. The decision regarding which type of modified opinion is appropriate depends upon:

- The nature of the matter giving rise to the modification – that is, whether the financial statements are materially misstated or, in the event that it was impossible to obtain sufficient appropriate audit evidence, may be materially misstated; and
- The auditor's judgment around the pervasiveness of the effects or possible effects of the matter on the financial statements.

153. The auditor should express **a qualified opinion if**: (1) having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or (2) the auditor was unable to obtain

sufficient appropriate audit evidence on which to base an opinion, but concludes that the effects on the financial statements of any undetected misstatements could be material but not pervasive.

154. The auditor should express **an adverse opinion if**, having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

155. The auditor should **disclaim an opinion if**, having been unable to obtain sufficient appropriate audit evidence on which to base the opinion, the auditor concludes that the effects on the financial statements of any undetected misstatements could be both material and pervasive. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the audit scope that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 170519 provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

### **Emphasis of Matter paragraphs and Other Matters paragraphs in the auditor's report**

157. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, but there is sufficient appropriate evidence that the matter is not materially misstated in the financial statements, the auditor should include an Emphasis of Matter paragraph in the auditor's report. Emphasis of Matter paragraphs should only refer to information presented or disclosed in the financial statements.

158. An Emphasis of Matter paragraph should:

- be included immediately after the opinion;
- use the Heading "Emphasis of Matter" or another appropriate heading;
- include a clear reference to the matter being emphasised and indicate where the relevant disclosures that fully describe the matter can be found in the financial statements; and
- indicate that the auditor's opinion is not modified in respect of the matter emphasised.

159. If the auditor considers it necessary to communicate a matter, other than those that are presented or disclosed in the financial statements, which, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, and provided this is not prohibited by law or regulation, this should be done in a paragraph with the heading "Other Matter," or another appropriate heading. This paragraph should appear immediately after the opinion and any Emphasis of Matter paragraph.

## Annex II: Progress in implementation of recommendations given in AAR 2016

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
Assembly of Kosovo	<ul style="list-style-type: none"> <li>Ask from the Government and Independent Institutions a quarterly progress report on the recommendations given by the AG in AAR 2016, and the recommendations of the Committee on Oversight of Public Finances related to this report; and</li> <li>Ask from the Government and Independent Institutions to consider the reasons why a number of previous year's recommendations have not been implemented.</li> </ul>	<i>Chapter 2</i>		
		<p>The action plan was prepared and submitted to the Assembly (COPF), but the Government had not responded to several meetings organised by the COPF.</p>	<ul style="list-style-type: none"> <li>We have not encountered requests by the Assembly addressed to the Government regarding the quarterly reporting and the progress achieved on implementation of recommendations.</li> </ul>	
		<i>Chapter 3</i>		
	<ul style="list-style-type: none"> <li>Government of Kosovo monitors implementation of objectives established in the Strategy for Internal Control of Public Finances; and</li> <li>Through COPF obligates all BOs to report on the process of implementation of recommendations issued in the individual audit reports by NAO.</li> </ul>	<ul style="list-style-type: none"> <li>From individual reports we have ascertained that only a number of BOs have drafted the strategic plan.</li> </ul>	<ul style="list-style-type: none"> <li>The recommendation was not implemented, as it was repeated this year as well.</li> </ul>	

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
<b>Assembly of Kosovo</b>	<ul style="list-style-type: none"> <li>It exert its impact over the Government to ensure that our recommendations for current and prior year are fully addressed in the area of procurement; and</li> <li>PPRC timely monitors the implementation of electronic procurement.</li> </ul>	<p style="text-align: center;"><i>Chapter 4</i></p>	<p>During this year the electronic procurement has been applied by most of BOs</p>	<ul style="list-style-type: none"> <li>Has not been implemented this year either, in certain cases they have increased.</li> </ul>
	<ul style="list-style-type: none"> <li>The Assembly of Kosovo to address the legal amendments for this area in order to allow public institutions carry through their constitutional and legal mandate.</li> </ul>		<p style="text-align: center;"><i>Chapter 6</i></p>	<p>Was initiated the revision of relevant laws: law on internal controls was issued, the law on commercial associations and on accounting, on financial reporting and auditing has been amended, while the law on POEs is in the process of being amended.</p>
<b>Government of Kosovo</b>	<ul style="list-style-type: none"> <li>The Minister of Finance in coordination with the Director of Treasury, to ensure that budgeting of expenditures is done in adequate economic categories;</li> </ul>	<p style="text-align: center;"><i>Chapter 1</i></p>		<p>From the Treasury were organised two workshops with BOs of two levels, including the Budget/MoF, to address these problems with the support of the USAID.</p>

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
<p><b>Government of Kosovo</b></p>	<ul style="list-style-type: none"> <li>• The Minister of Finance, in coordination with the Director of Treasury, should ensure that explanatory notes on capital assets, receivables and consolidation of intergovernmental transactions are complete and accurate, and on the status of public debt;</li> <li>• The Minister of Finance in coordination with the local government BOs should develop a more efficient process of monitoring and evaluating the trend in relation to the execution of the revenue collection plan;</li> <li>• That capital projects' planning is subject to controls over project management in accordance with the initial plans. An adjustment of cash flow with project planning is indispensable to address the low levels of financial performance of capital projects;</li> <li>• To review existing financial reporting arrangements to enable BOs enhance in terms of quality in financial reporting. Further on, it should ensure that regular training is carried through with responsible officials involved in financial reporting;</li> <li>• To enhance accountability against Budget organisations involved in the implementation of borrowing funded projects.</li> </ul>	<p>The Ministry of Finance this year has provided more qualitative disclosures of information on the stock of debt, balance of debt per creditor, and financial instruments.</p>	<p>Two workshops were organized by the Treasury with BOs of two levels, with the support of USAID, where was addressed the issue of reporting. On quarterly basis should be held meetings with all BOs that implement projects with borrowing. In addition, every 3 months report on the stage of project implementation and challenges.</p>	<p>Even this year, non-implementation of revenue plan was affected by local Budget Organisations, where 15 municipalities had a budget implementation rate of 70% of the revenue plan.</p> <p>Not addressed yet.</p> <p>It has not yet been addressed, because implementing BOs of planned projects to be financed through borrowing remains low.</p>

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
<p><b>Government of Kosovo</b></p>	<ul style="list-style-type: none"> <li>The Ministry of Finance, in coordination with BOs, should apply a close oversight when it comes to the implementation of agreements on donations;</li> <li>The Minister of Finance should consider the current mechanisms related to the management of public assets. The interaction between the two current mechanisms (KFMIS and e-assets) is a necessity to ensure that the BO maintains complete records regarding their overall assets; and</li> <li>The Treasury/Monitoring Division within MoF needs to exercise stricter monitoring controls in monthly reporting processes of outstanding liabilities.</li> </ul>		<p>Partially addressed. With the exception of the government grant where there was a very good level of budget implementation of 98%, the budget from other source funds was not used at the acceptable level.</p> <p>There are still a number of certain BOs that had not reported in compliance with legal requirements.</p>	<p>Not addressed yet, the amount of budgeted grants was spent at 71%.</p> <p>Not addressed yet, we have identified weaknesses in the management of public assets.</p>
	<ul style="list-style-type: none"> <li>Report on a quarterly basis regarding the progress and challenges in the implementation of recommendations given by AG in AAR 2016; and</li> <li>Apply an effective monitoring process on the implementation of action plans to implement recommendations. To undertake adequate administrative measures according to the legal framework, when competent bodies fail to implement recommendations;</li> </ul>	<p><i>Chapter 2</i></p>		<ul style="list-style-type: none"> <li>There are no quarterly reports from the Government on the progress of implementation of recommendations.</li> <li>Although the action plan for implementation of recommendations has been approved by the Government, there are no monthly reports on the progress made.</li> </ul>

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
<p><b>Government of Kosovo</b></p>	<p><i>Chapter 3</i></p> <ul style="list-style-type: none"> <li>• Managements of budget organisations pay special attention to the strategies' drafting processes, where stakeholders should be involved, so that strategies contain the financial cost and the measuring indicators;</li> <li>• Managements of budget organisations that have not yet addressed risk management at the appropriate level should ensure that concrete actions are taken to fully address this component through identification, analysis, assessment and risk management;</li> <li>• Managements of budget organisations that have not established the IAU should establish this Unit, through which would be ensured efficient and effective functioning of the internal control system;</li> <li>• Managements of budget organisations that have not established the AC should establish these committees; and</li> <li>• Management of MEST initiates revision of the Law no. 04/L-032 on Pre-university Education in the Republic of Kosovo in order to avoid uncertainties related to the supply and management of textbooks. In addition, in coordination with the MF, actions should be taken to ensure that the project for supplying textbooks is classified in appropriate budget Codes.</li> </ul>	<p>From individual reports was ascertained that only some of the BOs have drafted a strategic plan.</p> <p>Only 58% of the BOs have compiled a risks register as required under the FMC.</p> <p>Although BOs have a control system, in some of the BOs, recommendations related to management reporting and accountability have been repeated.</p>	<p>Eight BOs that meet the criteria to establish the IAU have not. No actions have been taken in this regard.</p> <p>In terms of AC, we have noticed that out of 64 BOs that have IAU, nine of them do not have an established AC.</p> <p>No measures have been taken related to the initiation of the revision of the Law on Supply and Management of Textbooks.</p>	

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
<p><b>Government of Kosovo</b></p>	<ul style="list-style-type: none"> <li>The reasons behind insufficient application of electronic procurement are identified;</li> <li>Electronic procurement platform is fully implemented in all institutions; and</li> <li>Recommendations given by performance audits “Management of procurement process for road maintenance” and “Follow up audit - Implementation of the contract for electronic procurement system” are implemented.</li> </ul>	<p>Recommendation was implemented</p>	<p>It has been implemented except for in two municipalities, and in seven independent institutions that was not used for small value contracts.</p>	<p>This recommendation will be evaluated after a follow-up performance audit is performed.</p>
		<p><i>Chapter 4</i></p>		
<p><b>Municipal Assembly</b></p>	<ul style="list-style-type: none"> <li>Mayors to report on regular basis to the Municipal Assemblies regarding the progress made and challenges faced in the implementation of recommendations given by the AG in 2016 AAR; and</li> <li>To implement an effective monitoring process on the implementation of actions plan for the implementation of recommendations.</li> </ul>		<ul style="list-style-type: none"> <li>In Municipal Assemblies (52% of them) were discussed the AFS, but not the action plan for implementation of recommendations.</li> </ul> <p>While progress in implementation of AAR recommendations has not been reported.</p>	<p>The effective process of monitoring of the action plan has not taken place.</p>
			<p><i>Chapter 2</i></p>	

Responsible institution	Recommendations given in the AAR 2016	Recommendations implemented	Recommendations partially implemented	Recommendations not implemented
<p><b>Board Chairpersons</b></p> <p>- <b>Shareholders of POEs</b></p>	<p><i>Chapter 6</i></p> <ul style="list-style-type: none"> <li>The shareholder should increase accountability of the Board Chairpersons to ensure that budget performance is improved.</li> <li>The Chairperson of the respective Boards should provide an analysis to determine the causes behind the Adverse and Qualified Opinions.</li> <li>The Chairperson of the respective Boards should provide an action plan determining the activities, deadlines and officers responsible for implementing the recommendations as well as apply an effective and formal process for monitoring the implementation of the AG's recommendations;</li> <li>Shareholders should request progress reports from the POEs managements regarding the recommendations given by the Auditor General in individual audit reports of the enterprises for the previous year.</li> <li>Shareholders should ensure that enterprises prepare a strategic plan or supporting document based on the National Development Strategy and Program of the Government;</li> <li>Ensure that through professional boards hold the Management into account to put controls and mechanisms in place for their functioning, especially when it comes to collection of revenues and expenditure execution.</li> <li>Shareholders of Publicly Owned Enterprises should ensure that they have initiated a review of the current legal framework related to POEs aimed at amending and synchronising laws and requirements in the field of reporting and audit of POEs.</li> </ul>	<p>The causes have been identified and actions have been taken to eliminate causes that influenced opinions, but they have not managed to eliminate all the causes.</p> <p>POEs have prepared action plans for implementation of recommendations, but implementation and monitoring needs to increase further. Progress towards the plan has not been reviewed systematically.</p> <p>Enterprises have an annual business plan, which covers the three-year period (this is done every year by each POE), this covers the strategic plan.</p> <p>Boards have ensured to hold managements accountable for the operation of controls, especially over the collection of revenues and expenditures.</p> <p>Yes. This issue has been initiated. Review of relevant Laws: the law on internal controls is issued, the law on commercial associations and on accounting, the one on financial reporting and auditing has been amended, while the law on POEs is in the process of being amended.</p>	<p>At the central level there is monitoring of POEs by MED as a shareholder, while the accountability is low. While at the local level (Municipal) POEs this process is only partially implemented.</p>	<p>Shareholder has not requested progress reports from POE management on implementation of AG recommendations.</p>

## Annex III: Main financial statements of the Government

### Statement of receipts and payments in cash for the Government of Kosovo for the year ended on 31st of December 2017

Shënim	2017		2016		2015	
	Managed by the Government of Kosovo '000 €	Third Party Payments '000 €	Managed by Kosovo Government '000 €	Payments by third parties '000 €	Managed by Kosovo Government '000 €	Payments by third parties '000 €
<b>RECEIPTS</b>						
Direct taxes						
Corporate Income Tax	2	75,277	80,817		67,660	
Personal Income Tax	3	136,924	123,982		108,677	
Property Tax	4	22,407	25,128		19,796	
Other Direct Taxes	5	3,426	2,194		1,588	
		238,034	232,121		197,720	
Indirect Taxes						
Value Added Tax	6	756,117	693,754		611,299	
Customs Duties	7	125,993	129,970		131,391	
Excise tax	8	432,279	403,296		360,633	
Other indirect taxes	9	847	372		153	
		1,315,236	1,227,392		1,103,476	
Tax returns						
Tax returns	10	-57,583	-38,381		-35,644	
		-57,583	-38,381		-35,644	
Non-tax revenues						
Taxes, charges and others from BOs, Central Governm	11	103,445	97,172		107,028	
Taxes, charges and others from BOs, Local Governmen	12	43,348	39,933		33,005	
Concession tax	13	8,519	7,683		6,533	
Royalty	14	30,570	30,554		29,700	
Revenues from dividends	15	-	-		15,000	
		185,881	175,343		191,267	
Borrowing						
External state borrowing	16	116,633	53,223		45,458	
Internal state borrowing	17	95,301	101,189		121,262	
		211,934	154,412		166,719	
Grants and donations						
Donor designated grants	18	8,312	386	8,735	3,255	13,310
		8,312		8,735		13,310
Other receipts						
Deposit funds	19	2,481	2,059		2,215	
Return of loans from POEs	20	9,350	7,209		1,500	
Dedicated revenues	21	9,390	9,018		5,500	
One-off PAK financing	22	326	-		61,311	
<b>Total Receipts</b>		<b>1,923,360</b>	<b>386</b>	<b>1,777,908</b>	<b>3,255</b>	<b>1,707,374</b>
<b>PAYMENTS</b>						
Operations						
Wages and Salaries	23	550,749		544,831		526,311
Goods and Services	24	204,161	5	183,050	103	185,921
Utilities	25	24,158		23,362		24,166
		779,068		751,242		736,398
Transfers						
Subsidies and Transfers	26	508,316		475,103		422,099
Capital Expenditures						
Property, plants, equipment, transfers	27	471,098	381	449,147	3151	406,832
Other payments						
Debt servicing	28	77,308		85,199		44,878
Membership fee for IFI	29	-		717		717
Returns from deposit funds	30	1,014		1,835		3,413
<b>Total Payments</b>		<b>1,836,805</b>	<b>386</b>	<b>1,763,242</b>	<b>3,255</b>	<b>1,614,337</b>
<b>Cash increase/decrease</b>		86,555		14,666		93,037
<b>Cash at the beginning of the year</b>	31	271,204		256,539		163,501
<b>Cash at the end of the year</b>	31	<b>357,760</b>		<b>271,204</b>		<b>256,539</b>

**Consolidated statement of the comparison of budget with the execution for the  
Government of Kosovo  
for the year ended on 31st of December 2017**

	Budget approved based on cash gatshme (Classification of payments by economic classification)					
	2017			2016		2015
	Initial Budget A	Final Budget B	Execution C	Budget Changes D=C-B	Execution	Execution
Note	'000 €	'000 €	'000 €	'000 €	'000 €	'000 €
<b>CASH INFLOW</b>						
Direct Tax	251,128	251,133	238,034	(13,099)	232,121	197,720
Indirect Tax	1,292,145	1,291,706	1,315,236	23,530	1,227,392	1,103,476
Khimet tatimore	(44,325)	(44,000)	(57,583)	(13,583)	(38,381)	(35,644)
One-off revenue from collection of tax debt	10,000	10,000	-	(10,000)	-	-
One-off tax revenue from SOE debts	3,000	3,000	-	(3,000)	-	-
Non-tax revenues	201,300	201,300	185,881	(15,419)	175,343	191,267
Borrowing	360,876	221,000	211,934	(9,066)	154,412	166,719
Grants and Donations	11,700	11,700	8,698	(3,002)	11,989	14,675
Other receipts *	23,075	22,300	21,547	(753)	18,286	70,526
<b>Total Receipts</b>	<b>2,108,899</b>	<b>1,968,139</b>	<b>1,923,746</b>	<b>(44,393)</b>	<b>1,781,162</b>	<b>1,708,739</b>
<b>CASH OUTFLOW</b>						
Other public services	294,688	210,813	193,212	(17,602)	171,491	324,404
Defence	51,313	36,285	34,914	(1,371)	44,081	34,769
Public Order and Safety	163,880	162,240	156,050	(6,190)	154,865	84,600
Economic affairs/relations	505,734	458,157	418,819	(39,338)	384,929	322,061
Environment Protection	9,659	10,982	9,934	(1,048)	10,570	13,915
Residence issue and Community	50,296	43,082	35,288	(7,794)	40,505	28,591
Health	194,041	186,958	178,607	(8,351)	167,843	164,752
Recreation, culture, religion	60,296	51,166	47,929	(3,237)	38,292	33,340
Education	288,838	293,651	282,747	(10,904)	280,153	261,914
Social Protection	382,275	403,203	401,370	(1,833)	386,017	298,348
Others **	84,974	84,974	78,322	(6,652)	87,750	49,008
<b>Total Payments</b>	<b>2,085,994</b>	<b>1,941,511</b>	<b>1,837,191</b>	<b>(104,320)</b>	<b>1,766,497</b>	<b>1,615,702</b>

(\*) Note: (\*) Includes, dedicated revenues, repayments of loans from public enterprises, PAK's one-off revenues and deposits receipts  
(\*\*) Includes, debt payment, IFR membership fees and returns from deposit funds

**Consolidated statement of assets in cash and balance of funds for the Government of  
Kosovo**  
for the year ended on 31st of December 2017

	Note	2017 Managed by Government of Kosovo '000 €	2016 Managed by Government of Kosovo '000 €	2015 Managed by Government of Kosovo '000 €
<b>Financial assets in cash</b>				
Central Bank of Kosovo	33	339,906	257,393	248,780
Trust Development Fund	34	5,047	4,125	3,962
Cash in transit	35	10,179	7,371	2,177
Accounts of embassies of Republic of Kosovo	36	1,045	929	535
Cash in hand (safe deposits)	37	1,583	1,385	1,084
<b>Total assets in cash</b>		<b>357,760</b>	<b>271,204</b>	<b>256,539</b>
<b>Balance of funds</b>				
Specific purposes				
Designated by Donors	38	6,837	7,280	10,160
Own Source Revenues carried forward	39	32,880	27,156	21,787
Development Trust Fund	40	10,321	10,058	8,541
Dedicated revenues	41	803	841	856
Other	42	14,722	13,109	12,708
		65,564	58,446	54,052
Undistributed		292,196	212,759	202,487
<b>Total Balance of Funds</b>	31	<b>357,760</b>	<b>271,204</b>	<b>256,539</b>