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**AUDIT REPORT
ON FINANCIAL STATEMENTS OF THE PRIVATIZATION FUND
FOR THE YEAR ENDED ON 31 DECEMBER 2010**

Prishtina, June 2011

TABLE OF CONTENTS

Executive Summary	4
I. Introduction	6
II. Audit Opinion.....	7
III. Status of Prior Years Recommendations.....	8
IV. Financial Outcome	9
V. Financial Statements.....	9
V.1 Compliance regarding the external reporting	9
V.2 Information Quality.....	10
VI. Financial Management	11
VI.1 Privatization Procedures – The SOEs Sale with Spin-Off	11
VI.2 Privatisation Accounts – Tender Submission fees	16
VI.3 Privatization Accounts - Deposit fees	17
VI.4 Liquidation Trust Accounts.....	18
VI.5 Expenditures through petty cash	19
VI.6 20% of employee entitlement and Employee trust account	20
VI.7 Conclusion (fulfilment) of Contracts	21
VI.8 Monitoring Process.....	22
VI.9 Contingent Liabilities	23
VII. Management Control	25
VII.1 Internal Control Systems	25
VII.2 Internal Audit	25
VIII. An overall conclusion on PF Management	26
Annex I. PAK Comments and OAG responses	27
Annex 2 Different types of Audit Opinions applied by OAG	30

List of Abbreviations

AFS	Annual Financial Statements
AG	Auditor General
CFTUK	Confederation of Free Trade Unions of Kosovo
IAS	International Auditing Standards
IAU	Internal Audit Unit
IFAC	International Federation of Accountants
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISSAI	International Standards of Supreme Audit Institutions
KB	Kosova Budget
KFMIS	Kosovo Financial Management Information System
KTA	Kosova Trust Agency
LPFMA	Law no. 03/L-48 on Public Financial Management and Accountability
LPP	Law No. 2003/17 on Public Procurement in Kosovo as amended and supplemented on 8 February 2007.
MEF	Ministry of Economy and Finance
OAG	Office of the Auditor General
PAK	Privatization Agency of Kosova
PF	Privatization Fund
SOE	Socially Owned Enterprise

Executive Summary

The Office of the Auditor General (OAG) has carried out an audit of the Annual Financial Statements of the Privatisation Fund (PF) for the year ended 31 December 2010.

Our audit was carried out in accordance with international auditing standards issued by INTOSAI and included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements.

In our opinion the Financial Statements *do not give a true and fair view*.

PAK failed to provide a transparent process during the privatization of Socially Owned Enterprises. The misleading information are the following:

- in securing consulting services for the privatization of “Sharr Cem” Enterprises (in the amount of €580,000), the standard open process was not followed;
- Sale of “Sharr Cem” Enterprise in amount of €30,100,000 (included around 42% of 2010 revenues) was not in line with the applicable legal framework. PAK failed to provide an open market for its sale. Therefore we are not sure if the value for money was achieved; and
- The enterprise “Sharr Salloniti” built a Business and Hotel Premise in amount of €693,256 without prior approval from PAK.

(ISSAI 400 Adverse Opinion)

Despite this, our audit has identified weaknesses in several areas of financial management. These weaknesses are described more in depth in the report.

A process of liquidation is in the initial phase since only one Enterprise has been liquidated. PAK neglected this process in general. It also neglected contract conclusions.

The Monitoring for commercialized enterprises was not performed in line with the contracts. Although, the agreements were not fulfilled in accordance with the contract, PAK never applied penalties or terminated contracts.

PAK in one case did not provide the relevant documentation which would prove the legitimacy of the employees in the list when it comes to distribution of 20% of employee entitlement.

In order to improve the functioning of financial management system and internal controls, we recommend you to ensure:

- Full compliance with the legal framework;
- Transparency and equal opportunities for all investors during the privatization process;

- Greater engagement in liquidation process;
- Commercialized SOEs administration and monitoring in line with the legal framework; and
- Distribution of 20% of employee entitlement adheres to the set criteria.

We recommend PAK Board to put in place and fully implement the legal framework as well as functioning internal controls. Based on this, ensure full transparency during the privatization process, as well as efficient and effective management of the Privatization Fund.

The Management of PAK has been given comments on a draft of this report. A number of subsequently changes have been made in this report.

Outstanding questions were we as auditors and the audited body still have different views are found in Annex 1.

The Management has committed themselves to make every effort to address the recommendations given.

I. Introduction

This audit relates to AFS of PF for the year ended on 31 December 2010.

It is the responsibility of PAK to prepare the AFS for PF according to the Regulatory Framework issued and approved by PAK. These statements are in accordance with the International Public Sector Accounting Standards (IPSAS) for “Financial Reporting under the Cash Basis of Accounting”.

The OAG is responsible for carrying out annual regularity audit of PF within your institution.

A Regularity Audit is defined as an attestation of financial accounting, involving examination and evaluation of Financial Statements and other financial records and expression of opinions on:

- Whether the AFS give a true and fair view of the accounts and financial affairs for the audit period;
- Whether the financial records, systems and transactions comply with applicable laws and regulations;
- The appropriateness of internal controls and internal audit functions; and
- All matters arising from or relating to the audit.

Initially, we carried out an interim audit, handling of recommendations given earlier and addressed issues of financial management during the current year. We have given advices to the management related to the issues addressed on annual financial statements through audit memo submitted in December 2010.

In order to fulfil our responsibilities for the audit of the AFS for PF, we have undertaken the following activities:

- Reviewed whether the AFS for PF are prepared in accordance with the Legislation;
- Established a materiality level of PF, as a threshold for assisting in determining the type of opinion to render on the financial statements;
- Used a combination of judgment and random sampling to select transactions for testing;
- Undertaken extensive substantive testing of financial transactions;
- Relied on a combination of interviews, analytical reviews, document reviews, and physical verification to assess the validity and propriety of financial transactions; and
- Assessed the quality of work of the Internal Audit Unit.

In this report we summarise this year’s audit and give a formal opinion on the Annual Financial Statement 2010.

In regard to our audit opinion for AFS for PF, the international auditing standards set out specific criteria that govern the type opinion that can be rendered.

These are set out more fully in Annex 2.

II. Audit Opinion

In our opinion the Financial Statements *do not give a true and fair view*.

PAK failed to provide a transparent process during the privatization of Socially Owned Enterprises. The misleading information are the following:

- in securing consulting services for the privatization of “Sharr Cem” Enterprises (in the amount of €580,000), the standard open process was not followed;
- Sale of “Sharr Cem” Enterprise in amount of €30,100,000 (included around 42% of 2010 revenues) was not in line with the applicable legal framework. PAK failed to provide an open market for its sale. Therefore we are not sure if the value for money was achieved; and
- The enterprise “Sharr Salloniti” built a Business and Hotel Premise in amount of €693,256 without prior approval from PAK.

(ISSAI 400 Adverse Opinion)

III. Status of Prior Years Recommendations

Our audit report of the Financial Statements for PF 2009 resulted in eight recommendations. Out of these, three have been fully addressed, three partially addressed, while the other two are not addressed.

The addressed recommendations are:

- Drafting the Internal Regulatory Framework for the form of reporting the Privatization Fund statements;
- Review of Tender policies and rules; and
- Compliance of Tender rules with operating policies regarding the return of deposits of non-winning bidders.

The partially addressed recommendations:

- Compliance of Tender rules with operating policies and signing the policies by the Board;
- PAK did not establish an Audit Committee. However, the same role was performed the Board of the Directors to whom the Internal Audit Office reported; and
- Timely application of penalties in case of failure of the contract and the exercise of Call Option in order to withdraw the shares if commercialization contracts were not fulfilled.

The recommendations which were not addressed are:

- Signing of contract in line with PAK policies and tender rules as well as the deadline and payment procedures are in full compliance with tender regulations; and
- Strengthening of internal control system and their implementation in order to secure transparent and effective operations and reduce the possibilities for mistake and mismanagement.

The failure to fully address our given recommendations has caused similar problems as previous years in the Ministry. Therefore, we express our concern for all unaddressed recommendations.

IV. Financial Outcome

PAK prepared a Business Plan for 2010 which foresees the activities and strategies of the Agency related to the Privatization Fund for the concerning period.

Table 1. Description of Accounts by Category

Description of Accounts	Active accounts in the end of the period	Balance of accounts as of 31 December 2010	Balance of accounts as of 31 December 2009	Difference
Privatization Trust Accounts	690	278,534,309	259,719,544	18,814,765
Liquidation Trust Accounts	145	214,480,470	175,188,793	39,291,677
SOE Trust Accounts (Money)	124	5,691,148	3,388,895	2,302,253
SOE Commercialisation Money in Trust	16	3,520,026	3,567,460	-47,434
Employee entitlement in Trust	69	9,662,836	132,986	9,529,850
Privatization Bids Deposits	1	3,139,227	3,391,091	-251,864
Privatization Tender Submission Fee	1	1,892,396	1,428,339	464,057
Liquidation Bids Deposits	1	1,371,067	638,468	732,599
Liquidation Bids Submission Fee	1	195,846	49,642	146,204
Liquidation Registration Fee	1	8,519	0	8,519
PAK Charter Capital	1	1,095,678	1,094,207	1,471
PAK Reserve Fund	1	2,591,945	2,433,523	158,422
Donor's Money	1	8,359	8,347	12
Time Deposit Accounts	6	1696.12	0	1,696
Total:	1,058	522,193,297	451,041,295	71,152,227

The table above shows the balance of all accounts at the end of reporting period, including the number of active accounts. The PF funds during this period increased for €71,152,227 as a result of the privatization process.

V. Financial Statements

V.1 Compliance regarding the external reporting

AFS of PF are prepared according to the requirements stemming out of the International Public Accounting Standards for Reporting under the Cash Basis of Accounting (IPSAS).

PAK addressed the OAG earlier recommendation by issuing the AFS Reporting Regulatory Framework on Disclosure of Trust Funds.

AFS are prepared fully in accordance with this Framework (however, the data was not reliable in terms of the regularity). The Financial Statements are signed by the authorized persons and submitted to MEF/Treasury within the time limits.

PAK summarizes, once a month, its activities related to privatization and liquidation in a report named as Management of Information Summary (MIS). The current MIS is always compared to the previous one.

PAK Management should report to the Board of Directors, and then the later should report to the Assembly of Kosova and makes publicly available quarterly reports summarizing the activities of the Agency and reflecting the financial results.

Lack of transparency while reporting

The Board reported before the Assembly, but did not make public the quarterly reports on the Agency's activities and result reflections.

In the end of the fiscal year, PAK published the annual report 2011.

Conclusion

PAK did not manage to ensure transparency for its quarterly reports by not publishing them in line with their legal framework (Article 20 of the Law no. 03/L-067).

Recommendation 1

We recommend the PAK Board to ensure:

- A transparent reporting process on the activities of Agency and reflection of financial results.

V.2 Information Quality

The Financial statements provide information to assist the decision making as well as evidence on the Organization responsibility on its sources and transparency during the spending of public money.

Wrong categorizations

PAK disclosed the trust fund expenditures (the liquidation account) in amount of €39,304. We tested this amount and noticed that these expenditures are related to unclosed advances. Out of this amount, only €200 were justified as expenditures.

Conclusion

Despite reporting of advances which are presented in financial statements as expenditures of trust accounts, we estimate that the information presented in the financial statements are registered in accordance with the cash basis of accounting.

Recommendation 2

We recommend the PAK Board to ensure:

- Proper controls over registration of expenditures and accurate presentation in the financial statements.

VI. Financial Management

VI.1 Privatization Procedures – The SOEs Sale with Spin-Off

The Agency's preferred method to privatize Social Enterprises (SOEs) that have sustainable business is the Spin-off method whereby the assets and limited liabilities of a SOE are transferred to the newly established unit of SOE (NewCo).

NewCo will be sold to an investor and the revenues from the sale will be deposited in a trust account to be used for fulfilling the outstanding liabilities of SOE and to deal with other complaints, including complaints about ownership. SOE will then be liquidated or bankrupted.

Despite this method, PAK in several cases uses the sale through liquidation, if it considers that such procedure is in the interests of creditors or respective owners.

In the table no.2 we have disclosed the flow of privatization trust accounts from the period 1st of January to 31st December 2010

Table no. 2 Privatization Trust Accounts (690 active accounts)

No.	Description	Period	Value in €
1	Privatization Trust Accounts	01 January 2010	259,719,544
2	Cash Inflows		75,422,141
3	Cash Outflows		56,607,377
4	Privatization Trust Accounts	31 December 2010	278,534,309

In the Privatization Trust accounts, the cash inflows reach the amount of €75,422,141. The main revenues of this account are those from the sale of Socially- Owned Enterprises (SOEs) €72,588,812, revenues from interest in amount of €338,782, bid deposit accounts €2,480,000 and other revenues €14,547.

While the cash outflows for the mentioned period was €56,607,377. Out of which, €30,399,088 were transferred to liquidation account, €12,721,241 were transferred to CFTUK (distribution of 20% of employee entitlements), €9,156,996 are transferred into the employee's account, and €4,087,398 are refunded to bidders and other outflows in amount of €242,653.

In this account we have examined completely the privatization wave 43 and 45a. These waves listed 24 enterprises for sale. Out of which, five enterprises have been successfully privatized in Wave 43 and seven enterprises in Wave 45a. The winning bidders (wave 45a) were in process of completing the payment. Despite this, we have tested one sale that has taken place through irregular procedure of sale. The examined samples regarding the payments made in 2010 reach the amount of €39,423,315 or over 54% of revenues from SOEs sales for this period.

While testing the privatization procedures, we have noticed that there is no sufficient control of how they are managed. This resulted in the findings outlined below:

In general evidences on the appointment of a committee by PAK on receiving-submission of bids are missing. The Opening was not made by the Board or the Committee appointed by the Board.

In line with PAK operating policies, Bid Receiving/Submission Committee should be appointed and bid opening should be made publicly by the Board or a Committee appointed by the Board, comprised of:

- A employee from the Agency;
- A representative from the Commercial Chamber; and
- A professional external legal expert with great reputation.

PAK Management failed to provide evidence on appointment of the Bid Receiving/Submission Committee.

PAK officials attended in opening of bids although external representatives did not participate. The same finding is included in the last year's report.

PAK started addressing our earlier recommendation. In the second half of 2010 the Agency established Bid Receiving/Submitting Committees in line with operating policies.

Qualifying ineligible operators

In one case we have noticed that the members of bid control qualified as eligible the bidder who failed to meet the criteria in accordance with Tender Rules. More precisely, we have verified the payments made by the bidders and have not found any evidence on payment of Bid Deposit in amount of €20,000 and submission fee in amount of €1,000.

Delays in notifying the winning bidder for payment of 75% of the bid price

From 30 tested samples, in 12 of them PAK had delays in many cases when it comes to notifying provisional winning bidders. There were also delays in notifying for the payment of 75% of the bid price. The delays resulted with negligence to the privatization process in general.

The same finding is included in the last year's report. However, the recommendation is not addressed yet.

Tender Cancellation for SOE from the sales list of Wave 43 without the Board approval

“Muliri” – Ferizaj was removed from the sales list without the approval of PAK Board of Directors. This indicates weak control in PAK related to privatization process in general.

PAK neglected signing the contract with the buyer of SOE

The new enterprise “Libraria Rilindja” – Istog valued at €51,150 made all payments within the defined time limits. However, the Agency delayed the process of signing the contract with the buyer. This kind of negligence by PAK delays the privatization process in general.

The Commercialist who failed to meet the Commitment agreement is awarded with the privatization contract

PAK signed a commercialism contract with the Enterprise “Egi Bau” for commercialization of “Zdrukthtaria” enterprise in amount of €251,480. The contract specifies the terms which should be met. The Commercialist failed to fulfil the commitment (investment, employment, and the rent foreseen under contract) in accordance with the contract. Despite this, the Agency granted the right to privatize the new enterprise Zdrukthtaria.

PAK justifies the Enterprise for not fulfilling the commitment agreement due to the fact that the Enterprise did not have under its ownership the entire property commercialized with PAK. (the property in the commercialization contract was 5,303 m² and the property usurped was 952 m²). Despite the justification given by the Agency, the Commercialist had around 4,350 m² in use and there was no reason why commitment agreement was not completely fulfilled.

Irregular procedures while contracting the counselling services related to privatization of “Sharr Cem” Enterprise

PAK has established the Procurement Unit which executes procurements under LPP. Despite this, PAK issued an internal regulation which governs the way how the supplies financed through Privatization Fund are handled.

In the contract “Contracting out Counselling Services for Transactions related to Sharr Cem Privatization”, we noticed that PAK preferred the winning company from the beginning.

The initiation of procedures related to this contract was made by the Procurement Unit. Then, this tender is cancelled and the Board took a decision for re-tendering through the internal procurement procedures.

According to this method, PAK failed to apply open procedures. However, it sent invitations to five companies regarding the Bid submission. Based on these bids, the winning company “Raiffeisen Investment” in amount of €580,000 was selected.

Based on this, we evaluate that procedures for selecting the advisor were not transparent. Furthermore, this Company had to set the sales value for the “Sharr Cem” Enterprise.

Avoiding regular procedures for privatization of Enterprise “Sharr Cem”

Revenues from SOE sales during 2010 were €72,588,812 therefore around 42% of revenues were generated from sales (privatization) of Sharr Cem Enterprise.

PAK established a Sales Department which is authorized for privatization of SOEs. When it comes to SOE privatization, the legal grounds ensure equal rights and transparency for all investors (domestic and foreign). The legal base is found in the Constitution as the highest legal act, Law on Privatization Agency and other operating policies.

In regard to the privatization of Sharr Cem enterprise, PAK did not adhere to procedures. It negotiated with the buyer who used (commercialized) this enterprise up to the moment of privatization. The price was negotiated by the Company contracted out for counselling services “Raeifeissen Investment”. The negotiation resulted in the agreement for the price of €30, 100,000 for which price the enterprise was sold.

Based on this, we conclude that PAK did not provide open market price when selling this enterprise. The irregularities noticed out of contracting the Advisor up to selling Sharr Cem drove us conclusion that the buyer of this enterprise is favoured. Therefore, we express our concern related to the privatization process of the concerning enterprise.

When it comes to transparency and privatization procedures, PAK justifies that on 09.08.2010 regarding the Sharr Cem sale has informed: the President of Republic of Kosova, the Government (the Prime Minister), the Assembly, European Commission Liaison Office, International Civilian Office and several Embassies.

The Agency failed to accurately disclose the land surface

In the privatization Wave 45a on two enterprises, we noticed that there was an inaccurate disclosure of land surface. Different land surfaces for these enterprises were presented in newspaper advertisements and memos of information. It is clearly presented in the table below:

Table no. 3 Description of Land Surface

No.	Description	Land Surface in m ² as per advertisement	Land Surface in m ² as per MoI (distributed to all bidders)
1.	Amortizatoret –Administrative Building	5ha, 20 are and 60 m ²	5ha, 7 are and 37 m ²
2.	“Fabrika e Amortizatoreve”	8 ha 28 are 70 m ²	8 ha 35 are 68 m ²

Conclusion

The noticed deficiencies related to privatization process in general are very serious and drove us to a conclusion that there is a weak control within PAK.

There is a lack of transparency from the beginning of procedures up to the contracting phase. The open market for privatization of Sharr Cem enterprise was not secured. All this lead us to a suspicion that there is a risk of fraud in this process.

Recommendation 3

We recommend the PAK Board to ensure:

- Implementation of operating policies during the entire privatization, starting from the appointment of the Committee, its composition, opening and registration of bids;
- Implementation of tender rules starting from the notification of provisional winner, notification for payment of 75% up to signing the contracts; and
- Control and transparency during the privatization process, in order to create an open environment, providing equal competition opportunities for all investors (domestic or foreign).

VI.2 Privatisation Accounts – Tender Submission fees

Based on the PAK privatization tender policies and regulations, the Agency requires from each bidder, to pay the fee (non-refundable fee) for submitting the bid in amount of €1,000 (for Spin-Off, regular). The following we outlined the flow of Privatization accounts – Tender Submission Fee for 2010.

Table no. 4 Privatisation Accounts – Tender Submission fees 1000435010000222

No.	Description	Period	Value in €
1	Privatisation Accounts – Tender Submission Fee	01 January 2010	1,428,339
2	Money inflows		531,596
3	Money outflows		67,540
4	Privatization Accounts – Tender Submission Fee	31 December 2010	1,892,396

In the Privatization accounts – Tender Submission Fee, as presented in the table above, money inflows amount to €531,596. Out of which, €418,450 are revenues from tender fees paid by each bidder, €110,000 are bid deposits transferred into Privatization tender submission fee while the rest are revenues from interest and other transactions.

The money outflow in amount of €67,540 is refund of bid deposits from privatization tender submission fee €40,000, tender submission fees €14,500 refund of tender submission fees €9,550 and the rest in amount of €3,490 provides other outflows in the administration of this account.

We tested the Money outflows and examined 78 samples (Bidders for the tenders), which reach the amount of €85,000. In percentage our sampling includes around 20% of the population (revenues from tender submission fee). Our tests disclosed the following:

Non-adherence to policies and tender regulations when tender fee is applied

Tender policies and regulations require from each bidder to pay the fee in amount of €1,000 (for Spin-Off, regular). However, the Agency decided to set the fee for several enterprises in amount of €2,000. The Agency had no particular reason to increase the fees for these enterprises.

Conclusion

PAK did not have a proper control when applying tender fees. Therefore, they failed to provide equal treatment for all bidders.

Recommendation 4

We recommend the PAK Board to ensure that:

- Fees are set in accordance with the legal framework providing equal treatments for all bidders.

VI.3 Privatization Accounts - Deposit fees

Based on the PAK privatization tender policies and regulations, the Agency requires from each bidder who applies for the tender to submit the deposit along with his bid. The amount of the deposits is defined by the Board of directors which is specified with the tender regulations for each Spin-off based on the case.

Table no. 5	Privatisation accounts – deposit fees	1000435000000104	
No.	Description	Period	Value in €
1	Privatisation Accounts – deposit fees	01 January 2010	3,391,091
2	Money Inflows		14,017,752
3	Money Outflows		14,269,616
4	Privatisation Accounts – deposit fees	31 December 2010	3,139,227

In the Privatisation accounts – deposit fees, inflows as presented above are at amount of €14,017,752. The main account that comprises the amount is the Deposit Fee which is paid by each bidder and reaches the amount of €13,994,500. Other revenues are related to revenues from interest and other revenues of such fees.

While the outflow for this category for the abovementioned period was €14,269,616. Out of which, the amount of €10,672,000 are the outflows for refund of deposits to the non-winning bidders, €3,110,000 are transfers to the privatization account while the other part is related to seizures and other outflows.

We examined 78 samples (bidder deposits) in amount of €6,510,000 or 47% of the population (bid deposit inflows). Our testing disclosed the following findings:

Controversies between policies and tender rules regarding the deadline for refund of deposit

According to tender rules, the refund of the deposits to the non-winning bidders shall be done within 10 working days after the opening of bids, while based on PAK operating policies, the refund of the deposits to the non-winning bidders shall be done within 15 working days, after signing the contract of the stock purchase. We noticed that PAK did not refund the deposits

to the non-winning bidders within 10 working days after opening of bids; respectively before the contract signing for stock purchase.

This was in accordance with the tender regulations but does not comply with operating policies. The same finding is included in the last year's report.

PAK started to address our recommendation: on 13th of September 2010, PAK Management addressed a MEMO to PAK Board requiring the compliance between operating policies and Tender Rules.

VI.4 Liquidation Trust Accounts

The liquidation committee is established for each SOE and is obliged to develop all procedures up to its full liquidation. The Committee should compile its asset register and an initial statement of its debts.

This committee informs all known creditors of SOEs in writing regarding the liquidation of SOE and the need for the creditor to file a complaint to the Liquidation Committee.

The creditors request should be registered and assessed by the Committee.

After this process is finalized, the approval is made by the Board and the members of the Committee are discharged.

In the table no.6 we disclosed the flow of liquidation trust accounts for 2010. In the end of this period, Liquidation trust accounts were in amount of €214,480,470 which resulted in increase of €39,291,677.

Table no. 6		Liquidation Trust Accounts (145 active accounts)	
No.	Description	Period	Value in Euro
1	Liquidation Trust Accounts	01 January 2010	175,188,793
2	Money inflows		41,906,575
3	Money outflows		2,614,898
4	Liquidation Trust Accounts	31 December 2010	214,480,470

Money inflows in the Liquidation Trust Accounts for this period were €41,906,575. Out of which, €30,683,635 or about 73% are transferred from the Privatization Account. The amount of €10,281,867 is collected from sale of asset liquidation and €941,073 is related to other revenues.

Money outflow for the Liquidation Trust Accounts for this period was €2,614,898. Most of this amount is related to employee transfer, CFTUK and payment of VAT in Tax Administration of Kosova. We have examined two waves from liquidation sales (sale 3 and

5). These sales reach the amount of €3,460,445 or 34% of the total value (liquidation sales for this period). Our testing disclosed the following findings:

Failure to fully apply the Tender Regulations

Our samples disclosed that there are small delays in notification of the provisional winner and delays in notification for payment of 25% of bided price Based on the Tender Rules: the deadline for provisional winner notice was three working days. However, the latest were informed in four working days).

Extension of deadlines during the liquidation sales resulted in delay of privatization process in general. The same finding is included in the last year's report. However, the recommendation is not addressed yet.

Conclusion

During the process regarding sales of liquidation assets, the control currently is weak and this caused delays in privatization process (sales through liquidation).

There is a need for greater engagement of PAK regarding the SOE liquidation since this process is in the initial development phase. Up to date, PAK managed to liquidate only one SOE.

Recommendation 5

We recommend the PAK Board to ensure:

- Qualitative service management towards the bidders especially when it comes to notifying the winning bidders and payment notification; and
- Greater engagement in SOE liquidation process.

VI.5 Expenditures through petty cash

In the financial statements of trust accounts for the period 2010, PAK disclosed petty cash expenditures in amount of €39,304. These expenditures are disclosed in the liquidation account – position outflow. The following, we outlined the findings regarding the use of petty cash:

Unclear rules on spending petty cash from trust accounts

PAK has no rule on use of cash register; however it relies upon the Guideline for PAK Liquidation Committee Members article 5.4 (advance payments in small amounts) and Regulation 2005/48 Article 44 (Expenditures of category a and b of liquidation funds). Further on, it relies on the Internal Procurement Guideline, which does not fully regulate the use of petty cash.

Advances registered as annual expenditures

PAK disclosed expenditures of trust funds (liquidation accounts) in amount of €39,304. We tested this very amount and noticed that they were unclosed advances (not including the value of €200). This value was not accurately disclosed in the financial statements.

Conclusion

PAK did not pay any attention petty cash management. They failed to issue regulations for its management and failed to adequately register the money outflows.

Recommendation 6

We recommend the PAK Board to ensure:

- Clear rules through which the procedures of spending the petty cash are regulated; and
- Registrations are made through adequate codes for outflows from petty cash funds.

VI.6 20% of employee entitlement and Employee trust account

Due to the special status of employees in Socially-owned Enterprises in relation to these Enterprises and the impact that the privatisation will have on this status, such employees are entitled to a share of the proceeds from the privatisation on a priority basis. This share shall be 20 per cent of the proceeds from the sale of shares. The amount shall be distributed for the benefit of eligible employees in accordance with Regulation 2003/13.

The total of 20% collected from SOEs sales during 2010 was € 22,736,209. Out of which, €21,878,238 are from sales through privatization, €843,270 from sales through liquidation, €13,227 are revenues from Bank interest and €1,475 other enterprises in trust.

From the total of 20%, €13,206,357 was directly transferred into CFTUK account for distribution. The rest, out of €9,529,852 is kept in a special account – Employees trust account”. This account is for later distribution, after the claims have been reviewed by the Special Chamber of Supreme Court.

The following we presented the flow of the employee trust account for this period:

Table no. 7 Employee trust account

Nr.	Description	Period	Value in Euro
1	Employee trust account	01 January 2010	132,986
2	Money inflow		9,529,852
3	Money outflow		
4	Employee trust accounts	31December2010	9,662,838

In the employee trust accounts, Money inflows as presented in the table above are in amount of €9,529,852. Out of which, €9,156,996 are transferred from Privatization accounts, €358,154 are transferred from liquidation account, while the rest are revenues from interest and other transactions.

PAK during 2010 distributed 20% of revenues from sales for employees of 46 SOEs or its units. Out of which, we have tested two samples (Beer Factory – Peja and Banja e Klokotit – Stacionari – Gjilan) in amount of €827,452. Expressed in percentage, our sample includes around 4% of the population.

Irregularities in distribution of 20% of revenues from sales of SOEs

Pursuant to *Article 10.4 of UNMIK Regulation 2003/13* -an employee shall be considered as eligible, if such employee is registered as an employee with the Socially-owned Enterprise at the time of privatisation and is established to have been on the payroll of the enterprise for not less than three years.

The distribution of 20% employee entitlement for Enterprise “Banja e Klokotit” was not made in line with the abovementioned rules. PAK did not provide a relevant document which would verify the legitimacy of the employees included in the list. The list is drafted in 2006 in period of KTA.

Conclusion

Based on the above findings, we conclude that PAK has insufficient controls regarding the 20% distribution process.

Recommendation 7

We recommend the PAK Board to ensure that:

- The control is improved in order that the distribution of 20% of revenues from sales of SOEs to employees is made fully in line with legal applicable framework.

VI.7 Conclusion (fulfilment) of Contracts

During 2010, PAK managed to finalize 99 contracts. Out of which 21 were tendered during 2010 and the rest, 78 contracts were tendered earlier.

Out of 99 finalized contracts we tested nine samples (six were from sales through privatization and three from sales through liquidation. These samples have disclosed the following finding:

PAK neglected signing contracts with buyers

If we refer to the Tender Rules, in three cases out of nine tested, the deadline foreseen for conclusion of contracts (more than 3 years) was delayed. If we refer to the PAK Operating Policies, we may conclude that no contract (of those tested) is completed within the deadline.

PAK officials argue that the long delays in contract conclusion occurred due to the fact that those contracts were inherited from former KTA. However, a part from this delay is due to the PAK negligence regarding the process.

Conclusion

PAK Control over contract conclusion is currently weak and as such it caused delays in conclusion (signing) of contracts. Therefore, PAK should strengthen controls in order to avoid such cases.

Recommendation 8

We recommend the PAK Board to ensure:

- Functional controls within PAK, so the contract conclusion is made in line with set deadlines; and
- Reconciliation of operating policies and tender rules regarding the deadlines for contract conclusion.

VI.8 Monitoring Process

The main focus of the Monitoring Unit is to monitor companies that have been subject to commercialization in accordance with the terms of the contract.

The monitoring unit is required to monitor compliance with agreements reached with the winning bidders in line with investment and employments commitments made during the privatization with Spin-Off Special.

“Spin-Off Special” (SSO) applies in circumstances where there is an additional requirement for the bidders who submits investment and employment commitments, business and investment plans.

In this area we have examined two samples, specifically one sample in monitoring of enterprises with Spin-Off special (NBI Suhareka LLC) and one sample in commercialized enterprises (Fapoli).

Further on, we examined one sample regarding the expenditures incurred during the monitoring process (independent audit of the EGI BAU enterprise).

Our testing disclosed the following findings:

No measures were taken in relation to violation of contract

The commercialized enterprise “Fapoli” did not fully adhere the agreement signed with PAK. In terms of contract, the agreement in this case should be terminated.

According to PAK officials, the contract was not terminated since it expires in the end of 2011 and the enterprise will be subject to privatization. They also claimed that the termination of contract before time would be detrimental due to the fact that the Fapoli commercialists will be penalized during the privatization process (the right for pre-buying, which is owned under the contract, will be denied).

It is worth mentioning that Fapoli had the largest percentage of fulfilling the commitments (56% of committed investments and 70% of employment). Due to this, in general economical view PAK considered that it is more favourable if the Enterprise is allowed to operate than to stop it. However, under the contract, measures should be taken at the moment that contract is not fulfilled.

Conclusion

Based on the findings presented above we come to the conclusion that the Agency was not effective in monitoring the enterprises which were privatized by former KTA commercialization.

Recommendation 9

We recommend the PAK Board to ensure that:

- Penalties specified under contract are applied on timely basis in case of contract non-fulfilment; and
- Contracts with commercialists who failed to adhere to terms under the agreement are terminated.

VI.9 Contingent Liabilities

The contingent liabilities in the end of 2010 were €369,628 while in the end of 2009 were €22,898. The contingent liabilities during 2010 were significantly increased compared to prior years. These liabilities (contingent liabilities) may have an impact on PAK Trust Funds.

Increase of liabilities results from liabilities of SOE “Sharr Sallonit”. This enterprise had obligations towards the contractor “Bavaria” related to construction of Business and Hotel Premises in Han i Elezit in amount of €346,628.

PAK failed to administer with SOE “Sharr Sallonit” the following we presented findings related to management of this enterprise.

The Construction of Business and Hotel Premises in amount of €693,256 without the approval by the Agency

The Board of “Sharr Sallonit” contracted out an Economic Operator for construction of a Hotel under the request of Customs – Hani i Elezit, for construction of Business and Hotel Premises, without prior approval by the PAK. However, the Law on PAK requires that the business and investment plan is approved by the PAK.

Selection of the Operator (the Construction Company of Business and Hotel Premises) without any regular procedure

There were insufficient evidences on the way how the winning bidder for construction of hotel was selected. The Tender Dossier prepared by the Contracting Authority was missing and Criteria for selection of the Economic operator were not clear.

The PAK Management respectively Direct Administration Unit was not able to provide sufficient information and documents on selection procedures of the winning bidder.

The Board of Sharr Salonit approves the Business and Hotel Premises construction without getting the license from the Municipality of Hani i Elezit

The construction started before the license is granted from the Municipality of Hani i Elezit. The contract is signed on 28.08.2009 while decision 06.No.71/09; on granting the construction license dates 08.09.2009 (eleven days in-between).

The PAK Board decides to privatize the SOE even though construction of the Business and Hotel Premises was not completed

Although the hotel construction was not finalized, the PAK Board decides to privatize the SOE “Sharr Saloniti” (wave 40). The half of the payment was made concerning the Business and Hotel Premises construction. However, the rest in amount of €346,628 remained as liabilities. This amount was disclosed as a contingent liability in PAK financial statements.

Conclusion

Based on the findings above, we may conclude that PAK did not have proper controls regarding the administration of SOE “Sharr Saloniti” we raise our suspicion that the risk of fraud and misuse might exist.

Recommendation 10

We recommend the PAK Board to ensure that:

- SOEs are administrated always based on legal applicable framework.

VII.Management Control

VII.1 Internal Control Systems

Good system of internal control assists each budget organization in achieving its objectives to provide reliable financial reporting.

Our findings and conclusions from the privatization process in general, have presented that the internal control systems did not provide sufficient assurance that PAK achieved its objectives.

PAK failed to secure full compliance with the applicable legal framework. Respectively, there was no full compliance between operating policies and tender rules.

The Privatization Process was not transparent. We noticed this in privatization of Sharr Cem, which was sold in absence of an open market. Weaknesses were noticed in monitoring and conclusion of contracts.

Conclusion

We conclude that PAK failed to establish a good system of internal control that would ensure a transparent process of privatization, monitoring and conclusion of contracts in line with applicable legal framework. We consider that the level of internal control has not been in satisfactory level, and the Board of PAK should take all necessary measures for its improvement by implementing our recommendations in this report.

Recommendation 11

We recommend the PAK Board to ensure:

- Functional control and their implementation in order to secure transparent and effective operations and reduce possibilities for misuse regarding these funds.

VII.2 Internal Audit

Internal audit is an important segment to ensure senior management that the internal control mechanisms are designed and implemented appropriately. Where noticed that internal controls are not functioning properly, internal audit provides advices and recommendations on how to improve them.

Internal Audit Unit (IAU) during this period carried out five audits. The scope in all audits was mainly the year 2009, despite two audits (the audit of the Department of Budget and Finance and the Audit of Board Secretariat) which included first part of 2010.

Conclusion

IAU managed to draw conclusions and give clear recommendations in these audit fields. However they were mainly focused on covering the prior year period. Therefore, this unit should in the future include more processes related to current year in order to assist the Management regarding the existence and proper functioning of internal controls.

Recommendation 12

We recommend the PAK Board to ensure that:

- IAU in its plan includes more processes of the current year when it comes to audit of Privatization Fund Accounts.

VIII. An overall conclusion on PF Management

Based on the findings and conclusions presented in this report we come to a conclusion that PAK Board still did not manage to set up a functional internal control system and secure an adequate legal framework which would provide reasonable grounds for sound and efficient management of Privatization Fund.

The Privatization Process was not transparent. This is noticed within the privatization of Sharr Cem, for which they failed to provide an open market.

A process of liquidation is in the initial phase since only one Enterprise has been liquidated. PAK neglected this process in general. It also neglected contract conclusions.

The Monitoring for commercialized enterprises was not performed in line with the contracts. Although, the agreements were not fulfilled in accordance with the contract, PAK never applied penalties or terminated contracts.

PAK in one case did not provide the relevant documentation which would prove the legitimacy of the employees in the list when it comes to distribution of 20% of employee entitlement.

Numerous weaknesses in this report drove us to an overall recommendation for management of these funds.

Overall Recommendation

We recommend the PAK Board to engage in order to put in place and implement the legal framework and functionalize internal controls which secure full transparency during the privatization process including effective and efficient management of Privatization Fund.

Annex I. PAK Comments and OAG responses

Report Chapter	Agree	Partially agree	Do not agree	Comments from the PAK	OAG response
VI. Financial management					
<u>The Commercialist who failed to meet the Commitment agreement is awarded with the privatization contract</u>		X		The Private Enterprise “Egi Bau” fulfilled its obligations regarding the amount of investment and number of workers employed. The Enterprise “Egi Bau” has not fulfilled its obligations when it comes to rent payment. But at the same time, one part of this SOE’s property has been usurped and profit lost (according to the evaluation by the external auditor) is €283,248. For this reason, the PAK signed a statement with the Company “Egi Bau” which specifies: “By signing this declaration, the parties waive their right to request payment for contractual obligations which were not fulfilled, i.e. compensation for lost profit...” -The Evidence - the Court decision for reviewing the appeal of commercialist, the agreement between the PAK and the commercialist to solve disputes and external audit reports.	In the contract signed between the PAK and Egi Bau for commercialization of Enterprise “Zdruktharia”, conditions which should be met by the Commercialist are clearly defined (investment, employment and rent foreseen under the contract). The PAK justifies the Company for not fulfilling the commitment agreement because the company did not have under its ownership the entire property commercialized with PAK (property commercialization in the contract was 5.303 m² and the property was only usurped was only 952 m²). Despite the justifications by the Agency, the commercialist had around 4,350 m² in use and had no reason not to complete the fulfilment of the commitment agreement. Therefore, finding, conclusion and recommendation remain unchanged.

<u>20% of employee entitlement and Employee trust account.</u>			X	Funds for SOE “Banja Klllokot” - New Enterprise “Water Factory” are distributed on 24.11.2006, after the procedure for appeal to the Special Chamber of the Supreme Court was completed and after the Supreme Court issued a final decision. When it comes to the case of New Enterprise Stacionari funds were distributed in 2010 since it is related to assets of the same SOE and final list is confirmed by the decision of the Special Chamber of the Supreme Court (decision number SCEL-registered 06-016 dated 12.10.2006 accepted by the KTA, dated 18.10.2006. This Court's decision is final where the point 4 states: “This verdict is final, legally binding and cannot be appealed” quote ends. All legal procedures were adhered to during the review and preparation of the final list of employees.	We have never contested the decisions of the Special Chamber of the Supreme Court. However, we have expressed all concerns when it comes to forming the first list by the company and review of the list by the Agency in accordance with UNMIK Regulation 2003/ 1. Therefore, our finding, conclusion and recommendation remain unchanged.
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<u>Irregular procedures while contracting the counselling services related to privatization of “Sharr Cem” Enterprise</u>			X	The Administrative Instruction no.2/2009 on procurement procedures on trust funds that do not belong to the revenues from privatization and liquidation is fully implemented.	Our main concerns about this project are that PAK for contracting out the advisor followed the procurement procedures in accordance with the LPP. Then, it continued with internal rules. Besides, the internal instruction 02/2009 on the procurement procedures was not fully implemented. Procedures for deviation regarding the submission of bids are not approved (signed) by the PAK management, and bids are received electronically. Therefore, our finding, conclusion and recommendation remain unchanged.
			X	All procedures of the sale of Sharr Cem have been explained to the Auditors. The right of first refusal by the commercialist is based on Article 4.7 of the commercialist. Fair price shown is set by internationally well-known company and by international standards.	This finding relates to the abovementioned one (selection of the transaction advisor for the valuation of the Sharr Cem assets). Our main concerns are about setting the price by avoiding the open market which is required by law on PAK and guaranteed by the Constitution of the Republic of Kosovo as the highest legal act in Kosovo. Therefore, our finding, conclusion and recommendation remain unchanged.

Annex 2 Different types of Audit Opinions applied by OAG

(extract from ISSAI 400)

9. An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse (paragraph 14) or a disclaimer (paragraph 15) of opinion.

10. An unqualified opinion is given when the auditor is satisfied in all material respects that:

- (a) the financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;
- (b) the statements comply with statutory requirements and relevant regulations;
- (c) the view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and
- (d) there is adequate disclosure of all material matters relevant to the financial statements.

11. Emphasis of Matter. In certain circumstances the auditor may consider that the reader will not obtain a proper understanding of the financial statements unless attention is drawn to unusual or important matters. As a general principle the auditor issuing an unqualified opinion does not make reference to specific aspects of the financial statements in the opinion in case this should be misconstrued as being a qualification. In order to avoid giving that impression, references which are meant as "emphasis of matter" are contained in a separate paragraph from the opinion. However, the auditor should not make use of an emphasis of matter to rectify a lack of appropriate disclosure in the financial statements, nor as an alternative to, or a substitute for, qualifying the opinion.

12. An auditor may **not be able to express an unqualified opinion when** any of the following circumstances exist and, in the auditor's judgement, their effect is or may be material to the financial statements:

- (a) there has been limitation on the scope of the audit;
- (b) the auditor considers that the statements are incomplete or misleading or there is an unjustified departure from acceptable accounting standards; or
- (c) there is uncertainty affecting the financial statements.

13. Qualified Opinion. Where the auditor disagrees with or is uncertain about one or more particular items in the financial statements which are material but not fundamental to an understanding of the statements, a qualified opinion should be given. The wording of the opinion normally indicates a satisfactory outcome to the audit subject to a clear and concise statement of the matters of disagreement or uncertainty giving rise to the qualified opinion. It helps the users of the statements if the financial effect of the uncertainty or disagreement is quantified by the auditor although this is not always practicable or relevant.

14. Adverse Opinion. Where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position presented to the extent that an opinion which is qualified in certain respects would not be adequate, an adverse opinion is given. The wording of such an opinion makes clear that the financial statements are not fairly stated, specifying clearly and concisely all the matters of disagreement. Again, it is helpful if the financial effect on the financial statements is quantified where relevant and practicable.

15. Disclaimer of Opinion. Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to an uncertainty or scope restriction which is so fundamental that an opinion which is qualified in certain respects would not be adequate, a disclaimer is given. The wording of such a disclaimer makes clear that an opinion cannot be given, specifying clearly and concisely all matters of uncertainty.

16. It is customary for SAIs to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.