Republic of Kosovo

Public Expenditure and Financial Accountability (PEFA) Public Financial Management Assessment

May 2009

Acronyms

AC	Audit Committees
AGA	Autonomous Government Agencies
ANP	Aeroport Nderkombetar I Pristina
BO	Budget Organizations
CFA	Central Fiscal Authority
CHU	Central Harmonization Unit
CIAHU	Central Internal Audit Harmonization Unit
COFOG	Classification of the Functions of Government
DB	Database
DCFDM	Division of Cash Flow and Debt Management
DIA	Department of Internal Audit
DMU	Debt Management Unit
EC	European Commission
GDP	Gross Domestic Product
GFS	Government Finance Statistics
HQ	Headquarters
IA	Internal Audit
IAU	Internal Audit Unit
IFAU	Internal Financial Audit Unit
IMF	International Monetary Fund
IPA	Instrument of Pre-Accession
IPSAS	International Public Sector Accounting Standards
IRB	Independent Review Board
ISPPIA	International Standards for the Professional Practice of Internal Auditing
KCB	Kosovo Consolidated Budget
KDSP	Kosovo Development Strategy and Plan
KEK	Kosovo Energy Corporation
KFMIS	Kosovo Financial Management Information System
KPA	Kosovo Privatization Agency
LLGF	Law on Local Government Finances
MDA	Ministries, Departments and Agencies
MEF	Ministry of Economy and Finance (synonymous with MFE)
MFE	Ministry of Finance and Economy (synonymous with MEF)
MIT	Ministry of Industry and Trade
MPS	Ministry of Public Services
MTEF	Medium Term Expenditure Framework
MYR	Mid-Year Review
OAG	Office of the Auditor General
PE	Public Enterprises
PFIC	Public Financial Internal Control
PIP	Public Investment Program
PISG	Provisional Institutions of Self-Government
POE	Publicly Owned Enterprise

PPA	Public Procurement Agency
PPL	Public Procurement Law
PPRC	Public Procurement Regulatory Commission
PRB	Procurement Review Body
PTK	Post Telekomi I Kosoves
RTK	Radio and Television of Kosovo
SN	Sub National
SOE	Socially Owned Enterprise
SRSG	Special Representative of the Secretary-General
STA	Single Treasury Account
TAK	Tax Administration of Kosovo
ULT	Unit for Large Taxpayers
UNIREF	Unified Reference Payment Code
UNMIK	United Nations Interim Mission in Kosovo
VAT	Value Added Tax

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Overview of the indicator set

	A. PFM-OUT-TURNS: Credibility of the budget	Score 2007	Score 2009
PI-1	Aggregate expenditure out-turn compared to original approved budget	N\A	C
PI-2	Composition of expenditure out-turn compared to original approved budget	N\A	A
PI-3	Aggregate revenue out-turn compared to original approved budget	A	A
PI-4	Stock and monitoring of expenditure payment arrears	D+	B+
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency			
PI-5	Classification of the budget	D	A
PI-6	Comprehensiveness of information included in budget documentation	D	B
PI-7	Extent of unreported government operations	C+	A
PI-8	Transparency of inter-governmental fiscal relations	A	B
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	C+	C+
PI-10	Public access to key fiscal information	A	B
C. BUDGET CYCLE			
C(i) Policy-Based Budgeting			
PI-11	Orderliness and participation in the annual budget process	B+	B
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	C
C(ii) Predictability and Control in Budget Execution			
PI-13	Transparency of taxpayer obligations and liabilities	B+	B
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C	D+
PI-15	Effectiveness in collection of tax payments	C+	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	B+	A
PI-17	Recording and management of cash balances, debt and guarantees	A	A
PI-18	Effectiveness of payroll controls	D+	D+
PI-19	Competition, value for money and controls in procurement	D+	B
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	B
PI-21	Effectiveness of internal audit	C	B+
C(iii) Accounting, Recording and Reporting			
PI-22	Timeliness and regularity of accounts reconciliation	B	B+
PI-23	Availability of information on resources received by service delivery units	D	D
PI-24	Quality and timeliness of in-year budget reports	B+	B +
PI-25	Quality and timeliness of annual financial statements	A	A
C(iv) External Scrutiny and Audit			
PI-26	Scope, nature and follow-up of external audit	D+	B
PI-27	Legislative scrutiny of the annual budget law	B+	C+
PI-28	Legislative scrutiny of external audit reports	D	C+
D. DONOR PRACTICES			
D-1	Predictability of Direct Budget Support	N\A	D
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	N\A	D
D-3	Proportion of aid that is managed by use of national procedures	N\A	D

Summary Assessment

This Report provides an assessment of the status of the Public Financial Management (PFM) systems and processes of Kosovo as of March 2009. The Report has been produced in accordance with the internationally recognised Public Expenditure Financially Accountability (PEFA) methodology and, as such, it provides a direct comparison with the 2007 PEFA assessment.

The Government of Kosovo made itself aware of the importance PEFA process in 2007 because of the first assessment, which was conducted by the World Bank. The Government implemented the methodology at its own direction starting with a training workshop in December 2008 and the establishment of both a PEFA Steering Committee and Secretariat at the Ministry of Economy and Finance to carry out a comprehensive self-assessment of PFM using the PEFA methodology. The Government Team was supported by in-country Advisors on USAID, World Bank and DFID supported projects as well as a DFID funded consultant experienced in PEFA assessments. The work benefited from a two-day residential workshop where the PEFA team discussed all of the indicators. A draft of the indicator set was subsequently circulated to Government of Kosovo stakeholders for comment on the indicator assessment and scoring. A draft report based on the outcome of this process was then circulated in March 2009 to solicit comments from Kosovo's development partners and by the PEFA Secretariat in Washington DC. That draft and comments have formed the basis of this final report.

(i). Integrated assessment of PFM performance

Credibility of the budget

This group of indicators (PI-1 to PI-4) considers the extent to which the budget, as a plan, is a good indication of what happens in practice. It examines the variance between budgeted and actual expenditure and revenue, and whether unpaid/undisclosed bills distort actual reported expenditure. Poor scores point to the possibility that resources may not deliver the policy priorities reflected in the budget to the extent intended.

The relationship between the expenditure outturn and budget that had been established is not adequate with aggregate outturn expenditure being much lower than budgeted in the period from 2006 to 2008. Much of the recent under-spending has been on the capital account because of poor planning and inadequate procurement practices, but there has also been under-spending on the recurrent account emanating from lack of absorption and from over budgeting. Nonetheless, a far superior execution level was measured in 2008, pointing to improvements in this area. The unspent budget has been distributed relatively evenly among all Budget Organisations with the variances in excess of the total deviation at a maximum of 4.9% in 2008 and much lower in other years. Unavailability of funds has not been the reason for this under-spending as it has been achieved in the context of a revenue surplus emanating from positive economic developments that have been generated by remittances and increased domestic activity, particularly in the service sector. Increases in imports have resulted in increased tax revenue. These additional revenues have been used to boost reserves.

A concern with respect to revenue is whether these year-on-year increases can be sustained, which has led to a cautious approach to revenue forecasting. If these improvements are considered a continuing feature of Kosovo, then ensuring less caution in revenue forecasting will be beneficial, as it would give a better budget preparation perspective for Budget Organisations.

However, given the changing external economic environment worldwide, a more cautious approach may be warranted in the immediate future, with more realistic and achievable spending plans rather than the over budgeting experienced in the past three years.

The verified end-of-year financial statements of budget organisations show that the level of arrears as a share of total expenditure is negligible. However, a full and comprehensive age profile of expenditure arrears will not be available until compliance with rules for the use of the Treasury's "purchasing" module is improved.

Comprehensiveness and transparency

This group of indicators (PI-5 to PI-10) examines the extent to which instruments such as the budget and accounts of the Government reflect the totality of public finances. It examines the extent to which Government makes information available, in a suitable form, through which it can be held accountable for the way it manages resources. Poor scores indicate fiduciary risks due to the non-availability or fragmentation of information about public finances, the absence of opportunity for Government to be held accountable by its own population and a lack of external checks and balances that transparency otherwise makes possible.

The Kosovo Consolidated Budget (KCB) is comprehensive and there are no extra budgetary funds. The Chart of Accounts is COFOG and GFS 2001 compliant. Transfers to Municipalities (as well expenditure from own- sourced revenues) are also included in the Consolidated Budget and are formula driven and transparent, though in 2009 budget preparation. The information on final grants was later than desirable. Municipalities set their own budgets, which are readily available for scrutiny.

There is a good use of web-based dissemination of information to the public at large, though information could be made available in the MTEF and Budget in a more accessible way (use of historical comparison and summaries). There is a lack of information at the level of primary services.

Policy-based budgeting

Indicators PI-11 and PI-12 reflect the extent to which budget allocations are made in a strategic context reflecting agreed policies and priorities and with due consideration to the longer term impact of decisions. Low scores would indicate risk of fiscal instability, weak prioritisation, and linkage to policy objectives. They would also suggest vulnerability to imbalances between types of expenditure and inefficient use of resources due to "stopping and starting" of projects and lack of complementarities between different categories of expenditure.

The budget calendar template provides sufficient time for budget preparation and deliberation by Cabinet and Assembly. The 2009 budget preparation deviated from the template and the available time for budget preparation by Budget Organisations (BOs) was reduced. Moreover, the preparation of the 2009 budget suffered because the expenditure aggregates contained in the MTEF were changed two weeks after its publication and the Cabinet did not deliberate and approve the ceilings prior to the second Budget Circular being sent out to the ministries.

The MTEF document presents a mission statement and description of the existing situation, and goals for sectors, but these are not uniform in quality or clarity.

More comprehensive sector strategies are being developed under the EC-funded KDS project with sector ministry input. These reflect the much stronger analytical capability in the KDS project, which has consultancy support. The sector ministries would probably not be able to produce such a sector strategy independently. This reflects a weakness in the sector ministries in planning and budget preparation. The capacity to formulate ministerial budgets linking policy to plans and plans to budget formulation is still underdeveloped and has to be the next step of the MTEF. Kosovo has a Public Investment Programme under which investment projects are assessed as to potential viability. In practise, the recurrent cost implications are not factored into subsequent budgets and the lack of a coherent sector strategy means that projects are developed in isolation. The PIP is not integrated into the MTEF and is in effect a centrally driven list of projects.

Predictability and control in budget execution

Indicators PI-13 to PI-21 consider the extent to which managers and service providers inside the public service can deploy resources provided in the budget with certainty and timeliness and within a control framework that is effective in enforcing discipline without being so cumbersome that service delivery is compromised. A low score here indicates vulnerability to leakage, lack of discipline and inefficient use of resources due to those resources not being in the right place at the right time or applied in the right way.

Customs Kosovo collects those taxes imposed at the border and the Tax Administration collects all other taxes. Customs' operation administration is centred on the use of Customs software with its effective functionality for customs control, revenue collection, and audit. Business practices in the Tax Administration are not as well developed and require improving, particularly audit. Both tax-collecting agencies are dependent on the Ministry of Trade and Industry' s (MTI) Agency for Business Registering database, and the integrity of business registry information is a serious issue because of the lack of effective verification procedures in the MTI, even though the registration of taxpayers is a high priority. Arrears of tax liabilities are sufficiently high to be a concern and resorting to the Court to resolve issues on collection is inefficient.

Budget execution is controlled through the setting of allocation limits, which are based on forecasts of available resources and the individual needs of the spending institution, with due regard to seasonality of revenues and expenditures. The Treasury manages allocations through the year and controls budget execution and cash management based on the cash plan submitted by Budget Organizations themselves. The effective use of a Financial Management Information System is an important tool in managing and executing the budget.

In general internal control procedures are well understood and modern internal audit is being developed. The Government is implementing a Public Internal Financial Control (PIFC) regime with the goal of moving to a modern system, which harmonizes the control and audit of public resources in accordance with best international practice. Currently, out of 59 BOs, 50 have established IAUs staffed by a total of 83 Internal

Auditors including three pilot municipalities. However, 33 BOs function with only one auditor, which is considered insufficient for the efficient functioning of internal audit in terms of capability, and sufficient capacities for planning, managing, and effective IA.

The number of audits held so far is 292 and the number of recommendations made is 1,937, of which 53.6% have been implemented with a further 24.8% in the process of being implemented. With respect to the 21.9% of the recommendations that have yet to be carried out, some are in the process of being implemented and others are planned to take place in 2009 in line with the Action Plans.

Payroll is an issue that needs addressing. Kosovo currently has a payroll system but no integrated personnel database. As Budget Organizations update the payroll monthly, prior to the execution of the payroll, changes are made in a timely basis. An ongoing issue is the lack of budgetary control in the processing of the payroll, so while internal controls exists for changes to the payroll, these do not ensure that budget allocations or staff limits are not exceeded. In the end of 2006, the Payments Division initiated a cleanup of the database. One of the aims was to ensure that every person has an ID card number within the database. It also runs checks on a monthly basis to ensure that retired people who are older than 65 are not on the payroll nor paid.

A Public Procurement Law was enacted in 2004 that brings public procurement in line with international standards and practices. Data shows that over 80% of contracts by value were procured through competitive open bidding. Nevertheless, this figure masks some concerns with respect to procurement. A study on procurement concluded "(p)ublic tendering does not sufficiently reach the market. The tender documents and the requirements for qualification… are too complex and probably too ambitious regarding the obligatory requirements for participation in the tender procedure (financial, technical, and professional criteria). The market is not sufficiently prepared to reply to these complex and ambitious requirements". The report of the Auditor General on the 2007 KCF has highlighted a significant number of breaches of the public procurement regulations, but also positive progress in the field of procurement. Procurement information, including awards, is disseminated via the web.

As noted under PI-1 poor procurement is one of the causes of under-spending on the capital account and in Donor Practices (D-Indicators), donors do not use the Government's procurement system.

Accounting, recording and reporting

Indicators PI-22 to PI-25 reflect the adequacy of information about what happens to resources in practice as a means of both informing managers at all levels about their own progress and that of other levels in implementing the budget; and as a means of exerting control and ensuring transparency. Weak performance here implies vulnerability to sub-optimal usage of resources, slippage in performance and weak accountability. It would also have implications for the effectiveness of controls dealt with by the previous group of indicators since many of those controls are dependent on the flow of appropriate data.

The Treasury is serviced through the Single Treasury Account (STA) with the CBK, through which all Government revenues and expenditures are recorded. The STA can be accessed in real-time through on-line access to the account at the CBK. Reconciliations between Bank and Treasury records are performed on a daily basis. The financial information is inputted into the Financial Management Information

System, which produces reports. Records and information are produced, maintained, and disseminated to meet decision-making control, management, and reporting purposes, as needed.

Budget execution reports are by structure of the budget and present fund balance commitment on a monthly and quarterly basis for each economic category and Budget Organization. The fiscal reports are reliable and present all financial data in a timely manner.

External scrutiny and audit

Indicators PI-26 to PI-28 seek to show the extent and effectiveness of independent scrutiny of what the Budget Organizations' administration does. Low scores would tend to indicate a lack of independent oversight of the activities of the government.

The Office of the Auditor General has benefited from continuous audit training and providing knowledge on international audit standards. Audit activities of OAG for the KCB for 2007 were focused in 21 Budget Organizations, representing 71% of expenditures and 86% of revenues. A specific audit report for each BO is published on the website in which the detailed findings are presented. An Audit Report on Financial Statements of the Kosovo Consolidated Budget for the year ended 31 December 2007 was published in November 2008. A formal response by the MFE is included in the OAG report with a follow up comment by the OAG. This is also the case for individual BO audit reports. There is some evidence of follow up. OAG reports that in 2006, some changes had been implemented in the KCB, which derived from previous audit recommendations. However, OAG made some 971 recommendations in 31 BOs in 2006 and 2007. Nevertheless, 606 are still waiting implementation by the end of 2008. The Assembly and the Budget and Finance Committee review the Auditor General's reports within 2 months of receiving them, but these reports are not scrutinized very closely, as the capacity of various Assembly committees to examine and utilize reports on an in-depth basis is not yet as strong as it should be.

With respect to the Budget, the Assembly delegates its review of the draft budget to the Budget and Finance Committee, which lacks professional staff trained in analytical activities. The Committee generally focuses its attention largely on revenue and expenditure information in the Annual Budget Law. Procedures for the deliberations on the budget by the Budget and Finance Committee are well established, and they include engaging other Assembly Committees, the MFE and Government, as well as specific Budget Organizations in conducting hearings for the debate of the proposed budget.

Donor practices

Indicators D1 – D3 show how well donors integrate their support into the Government's budget process so that it reflects all available resources in a timely manner as well as the extent to which donors use Government systems to manage their support. Poor scores indicate potential weakness in the Donor – Government dialogue and processes that reflect perceived fiduciary risk by donors.

Some €208 million in direct budget support was pledged at the 2008 Donor Conference. €69.3 million was to be provided in 2008. However, no budget support was actually received by Kosovo from donors in 2008. There is no evidence of the Government agreeing with donors any in-year disbursement estimates of the donor budget support pledged during 2008.

The Donor Coordination Unit has typically sought and received historical information from donors regarding their actual yearly expenditures. These estimates were recorded in a centralized database known as "RIMS". However, at the time of writing this report, the most recent data in RIMS is for 2007. The level of donor funds received directly in the Treasury is generally less than 10% of total donor assistance. Many of the grant agreements that govern the designated donor grants that are received specify that the procedures to be used in expending such funds is different from the standard government procedures, including the areas of procurement and audit.

(ii). Assessment of PFM strengths

The strength of the existing PFM system in centred on the successful introduction and implementation of the Financial Management Information System. This has ensured that commitment control is applied in budget execution and that reporting on budget execution is timely and meets the need of management for effective decision-making. Other strengths are found in the areas of internal audit and control and external audit where the process is in place and capacity is being built up for effective implementation.

Although it is more difficult factor to quantify, there are additional important strengths, which are that all of the basic ingredients necessary for a national PFM system, are in place and are integrated with the above. This includes:

- Basic legislation which is updated as needed
- Annual budget legislation which provides each year's appropriations and policy guidelines
- An established annual budget process which includes all the necessary ingredients and which works on a familiar schedule
- Specific units and staff in each Budget Organizations who have the designated responsibility for budget formulation and execution
- An ongoing series of donor-provided technical assistance activities which cumulatively seek to build the PFM capacities of individuals, programmes, and Budget Organizations

(iii). Assessment of the impact of PFM weaknesses

Weaknesses can be summarized as:

- Budget Planning
  - The need to improve planning and budget formulation in Budget Organisations. Specific attention needs to be directed at improving the overall capacity to develop strategies and integrate the planning of the investment cycle into these strategies.
  - There is a well-articulated budget calendar, but in recent years, this has slipped in its application, which has impacted on the effectiveness of budget preparation. The lack of Cabinet approval for BO ceilings compromised the process in 2009.

- The linkage between the MTEF and the annual budget are not as defined as they could be with the annual budget and the first year of the MTEF not the same.

- Budget Execution
  - While revenue collection is buoyant, there are weaknesses in registration, tax audit and debt control.

- Budget Accounting and Controls
  - While payroll controls are adequate, the absence of a personnel database linked to payroll compromises the payroll function.
  - Failure to achieve best value for money through competitive procurement practices will continue to be a high-risk area. Further capacity building will be needed over a number of years in order to develop a well functioning and effective procurement framework.

- Budget Reporting and External Audit
  - The absence of information at the level of primary service makes it impossible to judge the effectiveness of public expenditure in relation to the delivery of basic services.

- External Scrutiny
  - The budget documentation is reviewed by the Assembly Budget and Finance Committee and the budget is debated and passed by Assembly. However, the capacity of the Assembly to analyse the budget should be improved.
  - With respect to accounts, the elected representatives do not scrutinise the audit reports in any signification way due to a lack of capacity.

(v). Assessment of the impact of PFM strengths and weaknesses on fiscal discipline, strategic allocations of funds, and operational efficiency.

Regarding fiscal discipline, the PFM system's main strength is that the budget formulation system and the budget execution/Treasury system are both robust and sufficiently well developed to provide for:

- Legal and functional frameworks, within which fiscal discipline can be defined, monitored, reported upon, and enforced.
  - o This is based on the existence of necessary legislation, the MTEF process followed by the annual budget formulation and execution processes, audit processes, reporting processes, and legislative oversight processes.
- Transparency and the availability of information to provide for sufficient scrutiny of results.

At the same time, however, there are also weaknesses in these some of these areas:

- Although the frameworks exist, their enforcement capacities are rarely invoked, and available information is insufficiently scrutinized and applied in routine or systematic ways.
- Deviations from the planned expenditure levels persist.
- There are few real disincentives for violating the concepts of fiscal discipline, and the established dates and rules underpinning the budget process are overlooked in order to provide for political decision-making.

It is likely that more rigorous or routine enforcement of existing tools regarding the exercising of fiscal discipline would provide for more effective and efficient use of Kosovo's finite resources, which are certain to be strained as the global economic crises continues and as the needs of Kosovo's growing population continue to increase.

Regarding the strategic allocation of funds, the same factors as above can be seen to be in place:

- The necessary frameworks and the necessary policy-related tools (including the MTEF) are in place, which address issues of national goals and strategies.
- Sufficient basic information is produced by sufficient information systems, so it is possible to determine and audit the planned and actual expenditures for many programmes.

However, there are three important considerations, which mean that it is not possible to state that the allocation of funds in Kosovo follows a strategic direction.

- The nature and timing of the issuance of statements of national priority
- The sectoral aspects of the MTEF are not used in the actual setting and execution of national priorities, and
- Delays in the issuance of the MTEF.

However, that does not meant that Kosovo's funds are spent in unimportant ways: Kosovo remains a poor country whose needs for health care, education, infrastructure improvements (including transportation systems, environmental protections, and energy production), social protection, and economic development exceed its existing capacities and resources to address fully. It is quite feasible to state that on a "de facto" basis, Kosovo's allocation of funds does indeed follow strategic directions.

Operational efficiency in Kosovo's service delivery processes remain a difficult area, for several reasons:

- Although the MFE's Budget Circulars request information about programme goals, objectives, and performance measures, few Budget Organizations provide such information and the MFE does not routinely enforce the requirement.
- Closely related to this, most Budget Organizations lack the information and the information systems upon which to base a service-delivery assessment process.
- There is little evidence that Budget Organizations systematically gather, monitor and evaluate, manage by, and report on service delivery – either its efficiency or effectiveness.
- Neither internal nor external audit processes have been routinely embraced by the management processes of many Budget Organizations as reliable sources of information through which to routinely improve the operational efficiency or effectiveness of service delivery activities or resource allocations
- In the absence of such information, it is not surprising that priority-setting and resource allocation decisions are made on other bases.

Based on the overall PEFA assessment process and scores, and on the analyses of them that are presented in the body and attachments to this report, Kosovo will develop specific topics for inclusion it its PFM Reform Action Plan, to be finalized in mid-2009 and implemented in that year and beyond.

(vi). Prospects for reform planning and implementation

The PEFA assessment has been produced specifically as an input into the development of a PFM reform Action Plan. This Action Plan will address the weaknesses that have been identified in the PEFA assessment, but it will also build on the considerable success that has been achieved in the recent past in budget execution and control. These have been achieved though the development of the Integrated Management Information System; the Chart of Accounts; the Single Treasury Accounts; and the development of internal audit and control, as well as external audit.

(vii). Key changes from 2007 to 2009.

Solid progress in the quality of PFM systems and processes has been achieved between 2007 and 2009, as measured by the PEFA methodology.

Summary Comparison of PEFA Scores 2007 and 2009.

Score	2009 (No.)	2007 (No.)
A	8	5
B or B+	11	6
C or C+	5	6
D or D+	7	9
No score	0	5
Improved Scores	13	-
Reduced Score	7	-

The improvements in scoring have, in some cases arisen purely because of small managerial or administrative improvements. The most significant developments, which influenced the changes in scores from 2007 to 2009, were developments in the budget execution system though the Financial Management Information System, Chart of Account and the Single Treasury Account, which improved the overall scores in Cash Management and Accounting Recording and Reporting. Internal audit and control and external audit also improved as the systems evolved since they were assessed in 2007.

Significantly, the deterioration in scores focused mainly on the budget preparation area, where the established practices were not followed regarding the budget process for 2009, in particular related to the budget calendar, the MTEF, and dissemination of information. However, it must be recognised that the February Declaration of Independence and the July Donor Conference contributed to this. There were lower scores in the area of tax administration, but this was due to the scoring standard relating to the information, rather than deterioration in practices. Explanations of the changes are presented by dimension below.

The 2009 PEFA was able to score all 31 indicators due to improvement in the information and data availability.

Reason for changes from 2007 to 2009 PEFA Scores				
PI	**Dimension**	**2007**	**2009**	**Reasons for change in indicator Score**
A. Credibility of Budget				
PI-1		N/A	C	N/A in 2007
PI-2		N/A	A	N/A in 2007
PI-4	(ii)	D	B	Procurement module in FreeBalance implemented
B. Comprehensiveness and Transparency				
PI-5		D	A	Free Balance introduced and implemented which facilitated CoA. Single Treasury Accounts also introduced.
PI-6		C	B	Increase from 2 to 6 documents
PI-7	(ii)	C	A	Since the last PEFA assessment, the Treasury has been successful in closing the off-shore bank account which donors had previously had a preference for depositing funds. All donor funds received in cash are now received in Treasury's STA and accounted for through the KFMIS.
PI-8	(ii)	A	D	Budget calendar not respected which reduced time for budget preparation.
PI-10		A	B	2007 PEFA indicates that information to primary units was made available which was not the case.
C. (i) Policy-Based Budgeting				
PI-11	(ii)	A	C	The expenditure aggregates contained in the MTEF were changed two weeks after its publication, the Cabinet did not deliberate and approve the ceilings prior to the second circular being sent out to the BOs, and substantial changes to expenditures were made for BOs after the issuance of final ceilings.
PI-12	(ii)	N/A	B	
PI-12	(iii)	D	C	Agriculture sector strategy produced.
PI-12	(iv)	C	D	2007 PEFA scores on what should be done rather than what happens.
C (ii). Predictability and Control in Budget Execution.				
PI-13	(ii)	A	C	The processes and staff within the TAK are not meeting the requirements of the legislation or good tax administration practice.
PI-13	(iii)	C	B	Appeals process is three stage – internal, independent, and finally to Courts
PI-14	(i)	C	D	2007 scoring generous) poor integrity of MIT data, which was not subjected to a sufficiently rigorous verification process; (ii) lack of systematic updating of MIT data at the TAK; (iii) lack of compliance measures to ensure businesses actually fulfilled their registration obligations; and (iv) allocation of business registration numbers for each business activity, with the result that individual taxpayers often had multiple numbers
PI-15	(i)	B	D	2007 Score Generous. No systematic way of addressing arrears which have proved to be high. Ineffective collection due to Courts
PI-15	(iii)	B	A	Improved process
PI-16	(i)	B	A	Improved process
PI-16	(iii)	B	A	Law on Public Financial Management and Accountability provides clear direction as to approval mechanisms for such adjustments of expenditures as well as their prioritisation.
PI-17	(i)	N/A	A	Procedures in place
PI-17	(iii)	N/A	A	Procedures in place
PI-18	(ii)	D	B	Improvements in data inputting and control
PI-19	(i)	D	B	Data improved. Though process and procedures good based on legal requirement, concern about application expressed.
PI-19	(ii)	C	B	Experience in application Decreasing trend as a result of more qualitative planning.
PI-19	(iii)	C	B	Procurement Review Board established and operating

				Experience in application IPRB is an independent institution mandated by Assembly to address complaints relating to procurement.
PI-20	(iii)	C	B	Improved compliance with financial regulation
PI-21	(i)	C	B	Application and extension of IA
PI-21	(ii)	C	A	Improvement in submission to OAG
PI-21	(iii)	C	B	Higher response rate to findings
C (iii). Accounting, Recording, and Reporting.				
PI-22	(i)	B	A	Improvement in revenue collection reconciliation
PI-24	(i)	B	A	Improvement in reports by structure of the budget and present fund balance commitment for each economic category and budgetary organization. All reports are presented in compliance with IPSAS.
C (iv) External Scrutiny and Audit				
PI-26	(i)	C	B	Improved coverage
PI-26	(i)	C	B	Improved timeliness
PI-26	(i)	D	B	Follow up improved
PI-27	(i)	B	C	2007 Score may have been generous as B not evidenced
PI-27	(ii)	A	B	2007 Score may have been generous as insufficient technical capacity to carry out work
PI-28	(i)	D	A	2007 no scrutiny
PI-28	(ii)	D	C	2007 no hearings
PI-28	(iii)	D	C	2007 no recommendations

Appendix 1: Links between the six dimensions of an open and orderly PFM system and the three levels of budgetary outcomes

	1. Aggregate fiscal discipline	2. Strategic allocation of resources	3. Efficient service delivery
A1 Budget credibility	*In order for the budget to be a tool for policy implementation, it is necessary that it is realistic and implemented as passed.*		
The budget is realistic and is implemented as intended	The budget has achieved a surplus, resulting from increased revenue fuelled by high import level resulting from remittances and the international presence. However, there has been a tendency to over-budget which results not from budget cuts (because revenue is available), but from underachieving ambitious spending targets.	The challenge will be to better forecast revenue while at the same time maintaining the more cautious stance, which is necessary given the nature of revenue sources and the global economic uncertainty. This would allow a better allocation of resources at the planning stage rather than increasing allocations during the budget execution stage. However, the over-budgeting, which has been experienced, has mean that planning is ineffective and the budget is not a realistic planning tool if it is clear that the original budget cannot be achieved. In the past year, there has been a big increase in investment. The opportunity to improve the capital stock will need to be carried out using improved project selection and appraisal methodologies linked to sector strategies as well as improvement in procurement.	Reflecting better revenue forecasts at the budget planning stage will allow better planning of inputs needed to achieve better and more efficient service delivery. However, too high expectations with respect to expenditure can dampen perceptions of what can be achieved.
A2 Comprehensiveness and transparency	*Comprehensiveness of budget is necessary to ensure that all activities and operations of governments are taking place within the government fiscal policy framework and are subject to adequate budget management and reporting arrangements. Transparency is an important institution that enables external scrutiny of government policies and programs and their implementation.*		
The budget and fiscal risk oversight are complete and fiscal and budget information is accessible to the budget		All expenditures and revenue are included in the Budget. Scrutiny of the budget by Assembly and its Economic and Finance Committee provides adequate transparency, but could be improved. Availability of information to the public could be improved to enhance transparency to civil society.	Weakness in applying IT to aggregate expenditure by function diverts staff from more useful activities such as improved planning at the budget formulation stage. The lack of information at the primary service delivery level inhibits transparency and can affect service delivery at local levels.
	A policy-based budgeting process enables the government to plan the use of resources in line with its fiscal policy and national strategy		

	1. Aggregate fiscal discipline	2. Strategic allocation of resources	3. Efficient service delivery
A3 Policy-based budgeting			
The budget is prepared with due regard to government policy	The adoption of the MTEF ensures that government policy is linked to planning in the context of a resource envelope which is realistically set.	The budget calendar provides sufficient time for due deliberation by Cabinet and the Assembly (Economic and Finance Committee) to establish ministerial ceilings that reflect broad policy objectives. However, this has not been followed, which has meant that the political involvement is too late for effective priority setting between sectors, and municipal budget are rushed though municipal assemblies. The allocation of ceilings to strategic priorities within ministries is yet to be as developed as the macro aspects of the MTEF, and the MTEF and strategic planning process need to be more fully aligned. Presently, the strategic allocations are driven more by the MEF and Cabinet than by individual Ministries, though they do participate in the process. The next stage of the MTEF needs to start delivering on the bottom up part of the process.	The underdeveloped nature of the bottom-up element of the MTEF will inhibit optimum service delivery
B1. Predictability and control in budget execution	*Predictable and controlled budget execution is necessary to enable effective management of policy and program implementation.*		
The budget is executed in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds	Taxpayer identification and the application of TIN is week. Audit and debt management and the application of modern computer systems are not as good as it could be, and reduces tax-raising potential particularly with respect to Tax Administration (non-Customs). The execution of the budget is based on planned allocation limits that are conveyed to budget holders. These limits are based on revenue forecasts and past	Less revenue collected than could be possible means that more resources could be available for spending or tax rates are higher than they need to be. Budget execution and control is based on the set budget both in terms of institutions and in terms of line item economic categories.	The predictability of available funds means that inputs are supplied when they are needed, subject to efficient procurement. Cash allocations for any institution are based on the requirements of the institution in terms of potential need constrained by overall cash availability, but these are often planned quarterly or longer, which

	1. Aggregate fiscal discipline	2. Strategic allocation of resources	3. Efficient service delivery
	needs and are set to ensure fiscal discipline is maintained while at the same time conveys predictability. The use of FreeBalance (KFMIS) allows commitment control and tracking of expenditures		enhances service delivery. This ensures that service delivery is part of the decision making process but cash availability is the ultimate deciding factor. Financial inspection focuses on top-down compliance as well as on improvements to overall financial management systems, which contributes to improved service delivery. Modern procurement practices need to evolve to ensure that budget agencies get value for money in the procurement of goods and services.
B2. Accounting, recording and reporting	*Timely, relevant and reliable financial information is required to support all fiscal and budget management and decision-making processes.*		
Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes	Cash balances are maintained on a daily basis through the STA and monthly expenditure and revenue reports are produced to ensure adequate decision-making information.	Information on actual expenditure against budget is provided at a disaggregated level.	The data that is being recorded will limit the bottom-up element of the MTEF and impacts on service delivery at the planning and budget formulation stages.
C1. Effective external scrutiny and audit	*Effective scrutiny by the legislature and through external audit is an enabling factor in the government being held to account for its fiscal and expenditures policies and their implementation.*		
Arrangements for scrutiny of public finances and follow up by executive are operating	There is scrutiny of the overall fiscal position both at cabinet and Assembly level, but this is more at the aggregate rather than detailed level	Scrutiny though OAG is based on audits which meet international standards. Performance audits have still to be fully developed and the Assembly needs to build capacity to fully evaluate the results of the work of the OAG.	Performance audits reporting to the Assembly has yet to be fully developed.

1. Introduction

This report represents Kosovo's first PEFA opportunity as an independent nation to conduct a self-assessment. It is also Kosovo' s second experience with the PEFA process as a World Bank led assessment was carried out in 2007 prior to independence.

Following the end of hostilities of the 1990s and until February 2008, Kosovo had been operating under a "hybrid" form of government -- it was administered by the UN Interim Mission in Kosovo (UNMIK) but a Constitutional Framework provided for the gradual transfer of responsibilities to the Provisional Institutions of Self-Government (PISG)[1]. In February 2008, however, using the guidelines of the UN's 2007 Ahtisaari Plan, Kosovo declared its independence.

The Ministry of Finance and Economy (MFE) is responsible for the full range of activities associated with most nations' top-level finance ministry, including establishing and implementing fiscal policy, the preparation of the Kosovo Consolidated Budget (KCB), the treasury function, tax policy and administration, and others. The KCB accommodates appropriations for all Budget Organizations.

Starting with the end of hostilities and continuing, in response to the high priority given to public financial management reform, a number of international development partners, including DFID, EAR, USAID, the World Bank, and the IMF have provided technical and financial support to build capacity and to improve PFM processes[2]. While this assistance has been very valuable and generally successful in helping to establish the basic elements of a national PFM process, both Kosovar officials and the donor community recognize that there is still an urgent need to develop a comprehensive strategy and a sequenced action plan on public financial management reform. This planning process, which began in mid-2008, will be completed in 2009, and it will focus on PFM from two directions – a vertical dimension, which focuses on the PFM needs and activities of specific ministries, and a horizontal dimension, which focuses on government-wide PFM needs and activities. The PEFA process is considered to be at the heart of the horizontal dimension of the PFM reforms, and so it has been undertaken both as part of this larger planning process, and, as an indicator of Kosovo's capacity to conduct important analyses of its progress as a government.

The purpose of this report is to provide Kosovo's government, as well as the donor community and others who are interested in Kosovo's development, with a structured assessment of Kosovo's PFM systems following the consensus and useful approach developed by the PEFA consortium. It is intended that the assessment will assist the MFE, the Office of the Prime Minister, the Assembly, and the donor community in developing and implementing a PFM strategy that will be an integral part of Kosovo's medium-and long-term development activities as well as its Medium-Term Expenditure Framework (MTEF). The review is also intended to serve as a key source of input to the preparation and implementation of a joint Government/donors program on public financial management and broader public sector reform and possible budget support.

[1]The UNMIK established the "Provisional Institutions of Self Government" as a partial and embryonic government to be administered by Kosovar officials, and it assigned most typical ministerial functions to the PISG – Finance and Economy, Health, Education, Transportation and Telecommunication, Labour and Social Welfare. However, UNMIK also established some institutions, which it would retain under its own control – Justice, Agriculture, Customs, publicly owned enterprises, and others – and these organizations, which UNMIK reserved for its own control were termed the "Reserve Powers". However, with Kosovo's declared independence in 2008, UNMIK-controlled organizations all came under the Kosovar government's control, and the designation of "PISG" and "Reserved Powers" ceased to exist.

[2] All of these partners have been consulted during the planning and the implementation of this PEFA self-assessment.

For the Assessment, the Government has taken clear and pro-active steps. First, in the autumn of 2008 it enacted two Government Decisions, which both emphasized its support for PFM reform and took specific actions to put that policy into operation.

The first Decision established and endorsed the concept of Public Financial Management reform, and the second Decision took specific steps to create three entities:

- A Steering Committee, chaired by the MFE Deputy Minister and consisting of senior officials from the MFE and related organizations (Prime Minister's Office, Ministry of Local Government, Ministry of Public Services, Public Procurement Agency, and others). The purpose of the Steering Committee is to guide the development and implementation of policy-level actions and decisions regarding PFM reform plans and new activities

- A Secretariat, reporting to the MFE Deputy Minister and consisting of a designated group of staff from the MFE, representing the Central Budget Department, Municipal Budget Department, Treasury Department, Central Harmonization Unit (that is, the (internal) Auditor's Office), and the Macroeconomic Department. The purpose of the Secretariat is to conduct the PEFA self-assessment process and then to use its results as one key form of input for the larger PFM reform action planning process.

- A Technical Working Group, consisting of representatives of specific organizations and functions, which are relevant to the PEFA process and the PFM reform planning process, and which will support the Steering Committee and the Secretariat on an as-needed basis.

In December 2008, to begin implementing the Government Decisions, the Deputy Minister of Finance and Economy held initial meetings with the Steering Committee and the Secretariat, in order to launch both groups. Further, he held a meeting for donors in order to introduce them to the MFE's PEFA planning activities. Also that month, the Deputy Minister, the Steering Committee, and the Secretariat received two full days of specialized PEFA training by international advisors who have benefited from the full PEFA training courses.

This PEFA self-assessment document is the result of the Secretariat's work from January to March 2009. During that time, the Secretariat staff conducted an analysis of all of the PEFA indicators, by reviewing the 2007 PEFA report, gathering and reviewing all relevant data, interviewing appropriate officials, preparing successive drafts of each Indicator, and conducting an ongoing series of assessment work-sessions (including an off-site work retreat). An initial draft was reviewed by all Government of Kosovo Stakeholders.

The Assessment Team was led by Azem Reqica (Central Budget Department), and also included Jeton Gashi (Municipal Budget Department), Shkelzen Morina (Municipal Budget Department), Arijeta Neziraj (Treasury Department), and Afrim Shala (Central Harmonization Unit) with specific support by Mehmet Semnica (Central Budget Department), Bernard Nikaj (member of the FRIDOM project) and Selim Thaqi (Macroeconomic Department). Finally, international advisors John Short (DFID funded), Kris Kauffmann and Magda Tomczynska (USAID funded), and Stephen Leeds (World Bank funded) intermittently contributed to the process, as well.

In Kosovo, public finances cover the Central Government and the Municipalities[3].

Table 1 Kosovo: General Government Expenditure 2008 Budget € million

	Wages and Salaries	Good and services	Utilities	Subsidies and Transfers	Capital Outlays	Reserves	Total
PISG Budget Organizations*	59.4	81.0	9.3	160.1	345.5	33.6	688.8
Reserved Power Organizations*	47.8	37.0	3.2	31.0	91.6	3.0	213.7
Central Government**	107.2	118.0	12.5	191.1	437.1	36.6	902.5
Municipality Governments	105.6	25.1	7.1	2.9	47.1	0.0	187.8
Total	212.8	143.1	19.6	194.0	484.2	36.6	1,090.3
Of which:							
	General Grant to Municipalities						38.6
	Education Grant to Municipalities						84.7
	Health Grant to Municipalities						18.0
	Own Source Revenues						37.5
	Property Tax Fund						9.0
Total expenditure covered by PEFA							1,043.8
of which Central Government (%)							82.8
of which transfers from Central Government to municipalities (%)							13.0
As a proportion of total Government (%)							95.7

Source: Ministry of Economy and Finance

*"PISG Budget Organizations" were managed by the Government of Kosovo and included: the Assembly, the Offices of the Prime Minister and of the President; and the Ministries of: Finance & Economy, Public Services, Agriculture, Trade & Industry, Transport & Communication, Health, Culture, Education, Labor & Social Welfare, Environment & Spatial Planning, Communities & Returns, Local Government, Energy & Mining, Internal Affairs, Justice, and some small organizations such as the Independent Procurement Commission and the Public Procurement Agency.

"Reserved Power Organizations" were managed by UNMIK and included: Customs, the Auditor General, the Kosovo Protection Corps, Police Services, the Courts system, the Kosovo Trust Agency (including POEs and SOEs), the Ombudsperson, and a variety of smaller organizations. These two classifications ceased to be used once Kosovo declared its Independence, when most central organizations came under the single Government of Kosovo. However, the classifications are used here in order to allow for comparisons with pre-Independence information.

** This designation represents to total of the 2 preceding designations immediately above, and so it is the equivalent of the central government of Kosovo.

[3] Kosovo follows an active process of decentralizing programs and responsibilities to its local governments. The municipalities are responsible for primary education, primary health care, and the normal range of local governmental functions. They are currently gaining responsibility for social welfare programs as well. Regarding administrative functions, municipalities have their own Assembly to set local priorities and to manage local decision-making, and they are soon to receive the authority to make certain payments on behalf of the Treasury.

This report identifies the share of public expenditures that is made by each of these two classes of general government. This analysis of PFM in Kosovo for the most part focuses on central government organisation though in some instances there are overlaps in processes (such as accounting and reporting). Detailed review and analysis of expenditure implemented by municipalities are not carried out. Nevertheless, the operation of transfers from the centre to local government is examined in line with the PEFA guidelines. Some ninety-six percent of public expenditure in Kosovo has been subjected to the PEFA assessment methodology.

2. Country Background Information

2.1 Description of country economic situation

Quality information on the economic situation of Kosovo is sparse given the newness of the country. Statistics in the country are very weak and the intended census has yet to be carried out. Thus the economic statistics presented in this PEFA assessment and in the reports on which the section is based are the best possible informed judgements, save for those on the country's public finances. The weakness of the statistical base has resulted in a number and substantial revisions of per capita GNP and GNI figures during the last few years.

As part of the Socialist Federal Republic of Yugoslavia, Kosovo developed from a predominantly agricultural economy into one based on mining and emerging industry. However, as the conflict between the Albanian majority in Kosovo and the Miloševic regime accelerated in Serbia, neglect of the industrial base led to a return to a largely agrarian economy. Income per capita fell by an annual average of 13 percent during the first part of the nineties as the industrial sector and employment contracted - to reach less than $400 per capita in 1995. The massive international response following the armed conflict in 1999 aided by a steady flow of remittances from abroad as well as domestic growth has now raised the average per capita income to about $1,400 per annum . Nevertheless, the population of Kosovo is not precisely known, because a national census has not been conducted since the end of hostilities in 1999. Current estimates range from 2-2.25 million people with 65 per cent residing in rural areas. In addition, social indicator information is not yet collected on a consistent basis by the Budget Organizations, which have responsibility for social activities on behalf of the population.

Even in the post-Independence period, with the departure of much of the UNMIK structure and its staff, the Kosovo economy remains somewhat dependent on, and thus vulnerable to changes in, the size of the international presence. Demand generated by the reconstruction efforts and the consumption of the international organisations and their staff have fuelled domestic demand and created a vibrant service sector. However, the contribution of the international donors to economic growth has fallen in recent years as donor-funded programmes have been reduced significantly, and as the Government sought to accelerate the pace of infrastructure development. To some extent, the slowdown of this engine of growth has been counterbalanced by growing local private sector activity, with new investment occurring in industry and construction as well as by increased government spending. Nevertheless, at the time of this PEFA assessment report, the global economy is experiencing significant slowdown, with many countries entering recession. The likely impact of the worldwide slowdown on Kosovo's own economy is not yet clear.

A sizeable Diaspora (in relative terms) continues to inject both capital and know-how, but non-Diaspora investment must take place on a larger scale in order to move Kosovo's economic development forward. Kosovo is a resource-rich country (lignite-coal, nickel and other metals), whose profitable long-term exploitation requires that residual ownership issues are resolved to generate the necessary investment. Unfortunately, the development of the energy sector and the availability of reliable electricity are both crucially needed to attract investors and to support industry in Kosovo, just at a time when the world economy is facing critical problems of its own in virtually every sector of the economy and in virtually every country.

Despite the recovery in per capita income, large formal unemployment and poverty are serious problems. The official unemployment estimates hover around 50 percent, and thousands of young people (including university-educated) are entering the workforce annually. Currently some 29,000 young people are entering the labour market every year. Even if the economy could move to a *permanent* growth rate of 6 per cent in fifteen years' time, unemployment will only have halved. ***This simple observation defines the real economic development challenge for Kosovo.***

The informal sector provides a safety net for many, but notwithstanding this, in 2002, 37 percent of the population were counted as poor, defined as living on less than €1.42 per adult equivalent.[4] Poverty is relatively shallow, however, with most poor households living just below the poverty line.

The economy is characterized in particular by a very high rate of domestic absorption. Kosovo is highly dependent on imports, which comprise around 50% of GDP, while exports are very low and cover only around 20% of imports. This is primarily because the production capacity of the economy is only just developing, is small, and is uncompetitive relative to the region in general. The financing of this continuing deficit is made possible by significant inflows in the form of remittances, both measured and unidentified, donor spending and changes in net foreign financial assets (NFA) of the banking system.

As noted, it is difficult to assess the extent to which this degree of both openness and dependence might be a channel through which the broader world financial effects are transmitted. Because Kosovo is a Euroised economy, it can improve its trade balance only through a *real* exchange rate depreciation, which in turn can be achieved only through lower relative prices with trading partners. This could come from wage reductions and improvements in domestic productivity/efficiency.

It can be argued that this longer-run adjustment is already underway. Over the past three years, the donor sector has contracted significantly and relative costs in Kosovo have fallen. Real total GDP has grown cumulatively by around 15% in three years, and government revenues are up around 35%. However, the trade balance deteriorated sharply over this period, largely because imports rose much faster than GDP, in both nominal and real terms. Yet despite this, net foreign assets of the financial system increased over this period, suggesting that imports have been financed by increased non-donor inflows. Starting from 2008, NFA will gradually fall reflecting the projected budget deficit.

[4] World Bank (2005): Poverty Assessment – promoting opportunity, security and participation for all.

Macro-economic Indicators

The table below gives a summary of the main macroeconomic indicators.

Table 2 Main macroeconomic indicators, 2007-2008, € million

	2007	2008
Gross Domestic Production	3,400	3,757
Consumption	3,810	4,176
Investment	967	1,236
Exports	343	410
Imports	1,720	2,065
Nominal GDP Growth	8.8%	10.5%
GDP Deflator	3.2%	5.3%
Real GDP Growth	5.4%	5.0%
Exchange Rate $:€ Range	1.21-1.30	1.30-1.47

Source: Macroeconomic Department-MEF and Exchange rates www

Real GDP growth in 2007 and 2008 has been around 5 per cent, which is close to average regional growth rates. The share of private investment in GDP was an estimated 22.7% in 2008 and total investment (private and public) as a share to GDP was an estimated 32.9% in 2008. Exports were only €343 million in 2007 and increased to €410 million in 2008 while imports were a factor of five greater than exports. Transfers amounted to some 24 per cent of GDP and around half of these transfers were generated by remittances.

The economy of Kosovo being small and open is such that domestic price movements are highly dependent on import prices. Inflation accelerated in 2008 compared to 2007. Prices, measured by the Consumer Price Index (CPI) increased by 9.4% in 2008 compared to an increase of 4.2% in 2007. During 2007-2008, the exchange rate fluctuated from €1 equalling $1.21 to $1.47 and so far, in 2009 it has ranged between $1.25 and $1.60.

Poverty Profile

Based on a recent Household Budget Survey conducted by the Statistical Office of Kosovo (SOK), the World Bank (2007) estimated poverty in 2003/04 and 2005/06 to have been at around 45 percent. The poverty gap during this period has been estimated at 12 to 13 percent, while the severity of poverty has been at 5 percent (WB, 2007). The extremely poor population stood at 13 percent in 2003, and 16 percent in 2006 (Ibid). With regard to income inequality, the World Bank considers inequality relatively low in Kosovo: the Gini coefficient was reported to be 30 in 2005, from an estimated 27 in 2003 (Ibid).[5]

[5] An index of 100 represents perfect inequality and zero prefect equality

Table 3: Kosovo Poverty Indicators, in percentage		
	2003/2004	2005/2006
Absolute Poverty	43.5%	45.1%
Gap	11.9%	13.3%
Severity	4.6%	5.7%
Extreme Poverty	13.6%	16.7%

Source: World Bank staff estimates from HBS data (2007)

The headline features contained in the World Bank report are:

Poverty has remained widespread and persistent since 2000 in Kosovo.

Larger households and households whose heads are females have higher incidence of poverty.

There is direct correlation between poverty and education.

An urban-rural gap is emerging in both income and non-income dimensions.

Non-income dimensions of welfare show better outcomes, but are beset by inequalities in access to, and low quality of, key public services.

A comparison between different groups of population by labour force status shows that the unemployed and per diem workers are more likely to be poor.

The social protection programmes in Kosovo have low coverage, but its social assistance program, the explicit anti-poverty program, is well targeted.

So far, migration and remittances have been effective ways to reduce poverty and may continue to be so in the short term.

2.2 Description of budgetary outcomes

The tables below summarize the development of the Kosovo public finances for the past three years. These cover general government actual expenditure and revenues, including grant financed spending.

Total revenues have been over 26 per cent of GDP in 2007 and 2008 (the two years where GDP estimates are considered robust) and tax to GDP has ranged between 21 to 22.5 per cent, which place Kosovo at the lower end of the regional tax to GDP ratio table. The performance in 2007 was affected in particular by the "one-off" revenue increase arising from the sale of a license for the second mobile telephone operator.

Table 4 Kosovo: General Government Revenue

	€ million			As share of GDP	
	2006	2007	2008	2007	2008
Total Revenue	713.1	899.3	954.8	26.5	26.7
Taxes	621.6	716.2	805.4	21.1	22.5
Direct Taxes	119.6	132.7	163.2	3.9	4.6
Indirect Taxes	502	583.5	642.2	17.2	18.0
VAT	258.6	313.8	363.2	9.2	10.2
Excises	161.9	191.4	203.9	5.6	5.7
Trade Taxes	82.3	81.2	93.4	2.4	2.6
Other	2.5	6.1	3	0.2	0.1
Tax Refunds	-3.3	-9	-21.3	-0.3	-0.6
Municipal and non tax revenue	91.5	108.1	137	3.2	3.8
Grants			12.4		0.3
One-off revenue		75.0		2.2	

Source: Ministry of Economy and Finance

Since 2006, tax revenue has grown each year but at a declining rate, increasing in 2006 by 23.3 per cent, in 2007 by 15.2 per cent and in 2008 by 12.4 per cent.

Table 5 Kosovo: General Government Revenue as share of total

	2006	2007	2008
Total Revenue	100.0	100.0	100.0
Taxes	87.2	79.6	84.4
Direct Taxes	16.8	14.8	17.1
Indirect Taxes	70.4	64.9	67.3
VAT	36.3	34.9	38.0
Excises	22.7	21.3	21.4
Trade Taxes	11.5	9.0	9.8
Other	0.4	0.7	0.3
Tax Refunds	-0.5	-1.0	-2.2
Municipal and non tax revenue	12.8	12.0	14.3
Grants	0.0	0.0	1.3
One-off revenue		8.3	

Table 6 Kosovo: Government Taxes as share of total

	2006	2007	2008
Taxes	100.0	100.0	100.0
Direct Taxes	19.2	18.5	20.3
Indirect Taxes	80.8	81.5	79.7
VAT	41.6	43.8	45.1
Excises	26.0	26.7	25.3
Trade Taxes	13.2	11.3	11.6
Other	0.4	0.9	0.4
Tax Refunds	-0.5	-1.3	-2.6

An examination of share of the total that the different taxes raise shows that the pattern has changed slightly over time. VAT is the most important of the taxes with respect to its contribution followed by excises. Trade taxes (customs duties) have declined in importance over time reflecting the world wide trend in trade liberalization and the reduction in nominal tariffs though it is important to recognize that both VAT and excise taxes are generated mainly at the border though the non protective levying of these taxes on imports.

With respect to expenditures, expenditure to GDP ratio increased from 19.3 per cent in 2007 to 26.8.3 per cent in 2008 and by some 45% with the capital account more than doubling (121%) compared to a 17% increase in the recurrent account. With the recurrent account, there was an increase in transfers relative to wages and salaries, and goods and services in 2008.

In 2006 and 2007 there has been a budget surplus, which was some €222.6 million (6.5% of GDP) in 2007.

Table 7 Kosovo: General Government Expenditure € million

	2006	2007	2008
Wages and Salaries	207.0	208.9	228.1
Goods and Services	153.4	154.0	167.9
Subsidies and Transfers	157.9	154.6	210.0
Total Recurrent	518.3	517.5	606.0
Capital Outlays	138.4	159.2	351.7
Total	656.6	676.7	957.6
As % of GDP		19.9	26.8

Source: Ministry of Economy and Finance

Table 8 Kosovo: General Government Expenditure

	As Share of Total			As share of GDP	
	2006	2007	2008	2007	2008
Wages and Salaries	31.5	30.9	23.8	6.1	6.4
Goods and Services	23.4	22.8	17.5	4.5	4.7
Subsidies and Transfers	24.0	22.8	21.9	4.5	5.9
Total Recurrent	78.9	76.5	63.3	15.2	17.0
Capital Outlays	21.1	23.5	36.7	4.7	9.8
Total	100.0	100.0	100.0	19.9	26.8

With respect to expenditure by function, General Services, the largest element, as a share of the total has declined from just under 25 per cent to just over 20 per cent while spending on Economic Affairs has grown from over 16 per cent to 29 per cent. This huge increase is related to the amount of capital expenditure in this function (57 per cent of the total), on roads in particular in 2008. Social protection spending (which is mainly recurrent) has decreased relative to other functions although it has grown in nominal terms as has education and health, which are mostly comprised of recurrent spending.

Table 9: General Government Expenditure by Function

	As share of total			As share of GDP	
	2006	2007	2008	2007	2008
General Services	24.6	19.6	20.1	3.9	5.4
Defence	2.6	2.7	1.9	0.5	0.5
Public Order & Safety	7.7	11.3	8.4	2.3	2.3
Economic Affairs	16.4	18.4	28.9	3.7	7.8
Environmental Protection	0.1	0.3	0.2	0.1	0.1
Housing & Community Amenities	2.0	2.5	2.1	0.5	0.6
Health	10.4	10.2	8.5	2.0	2.3
Recreation, Culture and Religion	1.2	1.2	1.3	0.2	0.3
Education	16.2	16.4	13.7	3.3	3.7
Social Protection	18.8	17.5	14.9	3.5	4.0
Total	100.0	100.0	100.0	19.9	26.8

2.3 Description of the legal and institutional framework for PFM

Starting from the cessation of hostilities, when UNMIK began to work with Kosovar authorities to establish the institutions of government (regardless of the eventual resolution of Kosovo's status), there has always been the understanding that the responsibility for PFM was an important issue and that it had to have a designated place in the executive branch of government. Initially, the Central Fiscal Authority (CFA) was formed by UNMIK (but administered under Kosovar control) to fulfil this function, and the CFA evolved into the Ministry of Finance and Economy in 2002. Although Kosovo was still under UNMIK jurisdiction until 2008, the MFE conducted the full range of national-level finance ministry functions, as laid out in the Constitutional Framework and the LPFMA

Currently, the overall legal framework is the Constitution of Kosovo. This was adopted on the 9th April 2008 and it came into force on 15th June 2008 with the handover of all responsibilities to the Government from the UN. The responsibility for public financial management, which had been shared between the PISG and UNMIK prior to Independence, is now in the hands of the Government, although a legacy of UNMIK policies and procedures is still found in many institutions and the Government's systems as a whole (e.g., the civil service pay and grading system). Many of these are in the process of change and "Kosovarization", routinely or as part of the implementation of the Ahtisaari plan regarding Kosovo's independence.

The Municipalities are constitutionally separate from the central government. They are subject to both the LPFMA and the Law on Local Government Finance, and although they have the capacity to generate and use local property taxes as well as Own Source Revenues (including user charges, traffic fines, etc), they still depend heavily on the central government for financing (Education, Health, and General Government transfers). As stated, their budgets are executed through the same Treasury system as that used for central government Budget Organisations.

The framework for public financial management is legislated through Law No. 2003/2, the *Law on Public Financial Management and Accountability* and its 2008 successor (Law no 03L-048 with the same name,)) as well as the Law no 03/L-049 on Local Government Finance. While the LPFMA provides the overall frame for public financial management there are other laws and regulations, which deal with specific activities, as well as the annual budget laws. The LPFMA is supported by subordinate legislation in the form of Financial Rules and administrative instructions. There are two central harmonization units: one for internal audit and the other one for Public Finances Internal Control. A PFIC Unit was established through a regulation issued in May 2006 by the Treasury. UNMIK Regulation number 1999/16 established in the second half of 2000 the Internal Financial Audit Unit (IAU) within the Central Fiscal Authority (CFA) and this operated until 2002 with the establishment of Provisional Institutions of Self-Government of Kosovo (PISG). In May 2003, the initial LPFMA was passed and article 8 established the Internal Audit Unit in MEF, which subsequently became the central department of Internal Audit in MEF with the responsibility for internal audit capacity building and conducting audits in PISG BOs. On November 16, 2006, the Assembly approved the Internal Audit Law and approved by SRSG on 6 June 2007 on internal audit. It established a Central Harmonization Unit (CHU) for settling internal audit standards, for training internal auditors and reviewing their performance (IAL, Article 6).

The Office of the Auditor General (OAG) was established by the UNMIK Regulation nr. 2002/18, which defined authorizations, responsibilities, and general standards for auditing the public sector. Under a new law nr. 03/L-075 of 15th June 2008, the OAG received more power and reports directly to Kosovo Assembly.

Law No 2003/17 covers Public Procurement in Kosovo and provides for the Public Procurement Regulatory Commission (PPRC), a body under the Assembly of Kosovo and the Public Procurement Agency (PPA), an executive body under the Office of the Prime Minister. While a Public Procurement Review Body (PPRB) is mandated under the Law to review complaints related to the public procurement process, it is still to be established by the Assembly of Kosovo

Tax revenue is collected through two separate departments with their own tax laws. The Law on Tax Administration and Procedures has been harmonized to comply with EU Legislation beginning 2005 and covers Corporation Income Tax, Personal Income Tax, and Value Added Tax. Amendments were enacted in 2008 for direct taxes and amendments are being drafted for VAT to comply with EU 6th directive for VAT. Kosovo Custom's legislation and procedures are determined by Custom and Excises Code nr. 03/L-109, which replaced UNMIK Regulation 2004/1.

3. Assessment of the PFM systems, processes and Institutions

3.1 Budget credibility

3.1.1 PI–1 Aggregate Expenditure out-turn

(i) The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure).

Since 2005, the Consolidated Budget of Kosovo has moved from a commitment to a cash system of accounting and control. Table 3.1.1 shows under-spending on primary expenditure by central government (including transfers to municipalities) in each year from 2006. The main reason is under-spending (increasing annually) in the capital account which stems from poor procurement and over budgeting.[6] Nevertheless, there is also under-spending on the recurrent account though less than on the capital account. Expenditure funded by Own Source Revenue (OSR) covering fees and charges, etc. is included separately, as its allocation is not planned by economic categories in the original budget, while in expenditures these OSR are classified by economic categories. This is akin to a contingency.

Table 3.1.1 Primary Expenditures: Original Budget and Actual (€)

Years	Original Budget	Expenditures	Deviation	Deviation (%)
2008				
Recurrent	596,965,053	567,173,239	29,791,814	
Capital	455,867,294	315,745,981	140,121,313	
Own – Source Revenue[7]	25,730,000	15,848,304	9,881,696	
Total	1,078,562,347	898,767,524	(179,794,823)	16.7%
2007				
Recurrent	508,784,480	484,157,083	24,627,397	
Capital	180,689,460	131,925,771	48,763,689	
Own – Source Revenue	11,000,000	8,736,825	2,263,175	
Total	700,473,940	624,819,679	(75,654,261)	10.8%
2006				
Recurrent	513,989,663	482,780,872	31,208,791	
Capital	152,010,337	117,407,941	34,602,396	
Own – Source Revenue	11,940,626	8,551,326	3,389,300	
Total	677,940,626	608,740,139	(69,200,487)	10.2%

[6] Capital budgeting requires further development of a multi-year approach in capital investment management; and capacity building in the planning, managing and implementation of the capital expenditures programme. World Bank Kosovo: Policy Note on Public Investment Management by Andrew Bird October, 2007

[7] OSR amounts include user fees and other charges, and are estimated at the start of the year. They are generally devoted to a variety of activities, but actual expenditures are dependent on the Budget Organization's success at actually generating the specific level of resources.

The table shows the degree of deviation from the actual budget and planned budget for central government: 16.7 % in 2008; 10.8% in 2007 and 10.2% in 2006. This under-spending is also to be seen in the context of significant increases in expenditures of 44 % in 2008 from 2007 reflecting a tendency to over-budget.

PI-1	Explanation	(Score- M1)
The difference between actual primary expenditure and the originally budgeted primary expenditure	**Score C** (i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15%	**C**

3.1.2 PI-2 Composition of Expenditure outturn

(i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years.

This indicator measures the extent to which reallocations have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. The total variance in the expenditure composition is calculated and compared to the overall deviation in primary expenditure for each of the last three years. Variance is calculated as the weighted average deviation between actual and originally budgeted expenditure, calculated as a percent of budgeted expenditure based on the spending of the 19 largest budget organisations with the remaining budget organisations consolidated.

The budgeted and actual expenditure variances are as follows:

Table 3.1.2 Total deviation and expenditures deviation of main budget lines allocations

Year	Total expenditure deviation (PI-1)	Total expenditure variance	Variance in excess of total deviation (PI-2)
2008	16.7%	21.6%	4.9%
2007	10.8%	11.5%	0.7%
2006	10.2%	12.2%	2.0%

PI-2	Explanation	(Score- M1)
(i)Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years	**Score A** The variances in excess of the total deviation have not exceeded 5% in any of the 3 years[8]	**A**

[8] These have been derived from the ministerial expenditure information, which is included as an annex.

3.1.3 PI-3 Aggregate Revenue out-turn

(i) Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.

Outturn and budgeted revenue data for 2006, 2007, and 2008 are presented below. In each year, actual revenue was higher than that forecast in the budget. Revenue improvements stemmed from increased GDP.

Growth in taxes collected at the border had a significant impact as it is the largest revenue head and this has been fuelled by increased imports, but other revenue categories have shown annual increases (apart from tax administration in 2008) .

The scoring structure gives a score of A where actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years. As performance has in effect been better than forecast, a score of A is given. The PEFA scoring methodology does not in effect recognize underestimation in revenue forecasts, and although Kosovo had an underestimation, and although a consistent underestimation of revenue generally points to a weakness in revenue forecasting, a score which penalized Kosovo would not be fully justified because remittances can be variable, and because it is appropriate for MEF to be conservative in its revenue forecasting.

Table 3.1.3 Aggregate budget and outturn revenues

Revenue forecast and out-turn € million			
Year	Budget plan	Out-turn	%
2006	622.20	684.26	110.0%
2007	654.80	873.75	133.4%
2008	831.86	877.11	105.4%

PI-3.	Explanation	(Score- M1)
Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget	**Score A** (i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years. .	**A**

3.1.4 PI-4 Payment Arrears

(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.

All claims that are received by the Budget Organization should be paid within the period of time as specified in the contract which is no later than 30 days after being received. When there is an outstanding commitment at the end of a fiscal year, the Budget Organization is required to (i) report these arrears to the Treasury and Department of Budget in MFE; (ii) report these arrears in their financial reports and (iii) immediately record a commitment and arrears in the Treasury's Financial Management Information System (FreeBalance) in order to reflect these arrears. Arrears information for 2006 and 2007 is presented in Table 3.1.4.

Table 3.1.4 Expenditure Arrears

2007				
Budget	Expenditures	Arrears	% of budget	% of expenditures
€m	€m	€m		
735.0	635.2	1.039	0.14	0.16
2006				
Budget	Expenditures	Arrears	% of budget	% of expenditures
€m	€m	€m		
711.9	627.1	0.9.13	0.13	0.14

The processing of expenditures in regional offices of Treasury is done within the day (EV Recording) and on the same day (or day after) these are submitted for payment in Central Treasury. Thus, there are no payment delays as far as the central level is concerned.

Total centralization of the payment procedures in the Central Treasury makes the flow of payment difficult because all relevant documentation should be submitted in the Central Treasury for document control and approval of the payment. Treasury has initiated a project for decentralization and allocation of expenditures in budgetory organizations to faciliate the process.

Based on arrears as reported by BOs, their percentage in relation to expenses is lower than 2%.

Score A

(ii). Availability of data for monitoring of stock of expenditure payment arrears

In 2007, the purchasing module was implemented in FreeBalance to facilite follow-up and execution of payments by inputing data from purchase requests and purchase-order forms. Implementation of the purchasing module has allowed the entering of the date of invoice which was issued in regional offices of Treasury. This potentially allows the timeline for when the payment was executed to be assessed and enables monitoring of the payments and expenditure calculations relating to procurement.

However, not all BOs have been entering invoice dates in KFMIS when the invoice is received, but are rather waiting until the payment is processed. This undermines the effectiveness of the KFMIS as a tool for monitoring, and measuring arrears and the Treasury has commenced efforts to improve compliance.

The data provided by BOs in their annual financial statements regarding arrears has been verified and proven to be a good source of information regarding arrears at the end of each year.

Reliable and complete data on the stock of arrears is generated through routine procedures at least at the end of each fiscal year. However, there are instances of inconsistencies between what is reported by BOs and the KFMIS.

Score B

PI-4	Explanation	(Score- M1)
(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock	**Score A** **(i).** The stock of arrears is low (i.e. Below 2% of total expenditure.	**B+**
(ii)Availability of data for monitoring of stock of expenditure payment arrears	**Score B** (ii). Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.	

3.2 Comprehensiveness and transparency

3.2.1 PI-5 Classification of the Budget

(i) The classification system used for formulation, execution and reporting of the central government's budget.

The Budget Classification/Chart of Account is based upon Government Financial Statistics (GFS) 2001 and is COFOG compliant. The classification system used includes:

- Functional classification using 10 groups at level 1 and sub functions
- Economic classification
- Administrative classification

While it is possible to produce consistent documentation according to these standards for all three categories, these are only routinely produced for the economic, administrative, and functional classification electronically for budget *execution* (outturn actual) and for the financial statements. Functional classification for budget *formulation* can only be produced manually at present, as the coding for administration within a ministry is the same as if "administration" were a function. For example when producing the function "administration" electronically within a ministry, the administration of education, health etc. is included. This requires a change in coding so that the functional classification aggregation is not compromised at the levels 1 and 2 at the budget formulation stage.

Nevertheless the budget documentation can be produced based on GFS 2001 and is COFOG compliant. The budget can be compared with outturn by function. This warrants a Score A. Despite this A score, addressing the coding issue for aggregation to functions would improve the quality of this activity.

PI-5	Explanation	(Score-M1)
(i) The classification system used for formulation, execution and reporting of the central government's budget.	Score A (i) The budget formulation and execution is based on administrative, economic and sub-functional classification, using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.	**A**

3.2.2 PI-6 Comprehensiveness of Information Included in Budget Documentation

(i) Share of the above listed information in the budget documentation most recently issued by the central government (in order to count in the assessment, the full specification of the information benchmark must be met).

The MTEF report and the annual budget are the two main documents, which are produced as part of the budget calendar. While the MTEF document does not required Assembly approval, it is still submitted to the Assembly for information. The Cabinet approves the MTEF document on behalf of the Government. The budget proposals, based on the updated revenue forecasts, are scrutinized by the Assembly. Ministry ceilings are set out in the MTEF document and ministerial budgets are drafted based on these ceilings. The following elements are included in the MTEF and Budget Documentation.

Element	MTEF	Budget
1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation, and exchange rate.	Yes	Yes
2. Fiscal deficit, defined according to GFS or other internationally recognized standard.	Yes	Yes
3. Deficit financing, describing anticipated composition.	Yes	Yes
4. Debt stock, including details at least for the beginning of the current year.	Yes	Yes
5. Financial Assets, including details at least for the beginning of the current year.	No	No
6. Prior year's budget outturn, presented in the same format as the budget proposal.	No	No
7. Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	No	Yes
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.	Yes[9]	Yes[10]
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	Yes	Yes

[9] Partially only economic and administrative

[10] Partially only economic and administrative

The following observations on the table are relevant.

- The Euro is the currency of Kosovo and there is no ability to influence its exchange rate. However, some expenditure (oil and minerals) is denominated in $ and there is no explicit exchange rate noted although a balance of payments forecast is included.
- The Government of Kosovo does not currently have any debt (due to previous legal restrictions and the current surplus of funds). "Fiscal deficit" is this context is defined as domestic revenues less expenditures, and the financing of this deficit is funded by donors and from reserves.
- Some information on current year expenditure is presented by administrative category but is insufficient to satisfy the requirement of element 7.
- With respect to the summarised budget data past information on revenue categories and economic classification is presented but not for functional or administrative categories. It is included in the financial statements.
- While a statement of Financial Assets is not included in the MTEF and Budget documentation, it is contained in the annual Financial Statement.
- The MTEF and Budget includes a section on the implication of changes in policy on both revenues (e.g. changes to taxes) and expenditure (e.g. changes to wages)

The 2009 Budget Document contains considerably more content that the previous budget documents. Scoring is based on this document and the most recent MTEF covering the period 2009-2011.

It is worth noting that Part IV Preparation and Contents of the Proposed Kosovo Consolidated Budget contained in Law No. 03/L-048 on Public Financial Management and Accountability imposes a much more demanding set of requirements than contained in this PEFA indicator. However, meeting these requirements is yet to be fully achieved and will be dependent on developing the bottom up aspects of the MTEF beyond the present achievements.

PI-6	Explanation	(Score-M1)
(i) Share of the above listed information in the budget documentation most recently issued by the central government	**Score B** Recent budget documentation fulfils 5-6 of the 9 information benchmarks	**B**

3.2.3 PI-7 Unreported Government Operations

(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported i.e. not included in fiscal reports.

The Government of Kosovo has been successful in implementing the Single Treasury Account ("STA") approach to budget management, and has no extra-budgetary activities. The

Law on Public Financial Management and Accountability requires that all public money that is collected by Budget Organizations be deposited in the STA and cannot be spent until it is appropriated. There is no evidence of violation of this legal requirement by central government agencies.

(ii) Income/expenditure information on donor-funded projects, which is included in fiscal reports.

Almost all appropriation of public money occurs because of the annual budget process, with the exceptions being a relatively small amount of Own Source Revenue (OSR) related to expenditure of user-charges levied by Budget Organizations and Designated Donor Grants, which are appropriated as they are received from donors in the Treasury accounts. Nonetheless, all expenditures of public money, including OSR and designated donor grants are included in the regular in-year execution reports and year-end fiscal reports – thus providing a complete picture of the operations of central government.

All donor funding received by the Government from donors in cash is channelled through Treasury. There are no bank accounts operated outside of the STA by Project Implementation Units or Budget Organizations for the implementation of donor-funded projects. Thus, Treasury has been readily able to include a complete register of Designated Donor Fund receipts and expenditures in its financial statements.

Since the last PEFA assessment, the Treasury has been successful in closing the offshore bank account in which donors had previously preferred depositing funds. All donor funds received in cash are now received in Treasury's STA accounts at the Central Bank and accounted for through the KFMIS.

The low percentage of total donor support received as cash (and therefore channelled through the Treasury) is an issue of concern measured in indicator D-1.

PI-7	Explanation	(Score-M1)
(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported i.e. not included in fiscal reports.	**Score A** (i). The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure)	**A**
(ii) Income/expenditure information on donor-funded projects, which is included in fiscal reports.	**Score A** (ii). Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind.	

3.2.4 PI-8 Intergovernmental Fiscal Relations

(i) Transparent and rules-based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations).

The system of intergovernmental fiscal relations originally established in 2001 and 2002 has undergone considerable changes since the previous PEFA assessment. While this system represented an already advanced fiscal decentralization, 2008 witnessed promulgation of legislation, which solidified and enhanced institutionalization of the municipal finance system. The Law on Local Government Finances (LLGF) was promulgated in June 2008 within the framework of legislation required by the Comprehensive Proposal for Status Settlement. The LLGF introduced transparent rules and secured funding for the delivery of minimum standard services by local governments.

The 2009 Municipal Budget, in particular financing from central government transfers, was both constructed and approved based on new principles introduced by the LLGF. The, aggregate amount of transfers and its allocation to individual municipalities complied with rules and procedures established in the LLGF[11]. Grants parameters were determined and approved by the Grants Commission, and officially communicated to all municipalities through Budget Circulars[12].

Score A

(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year.

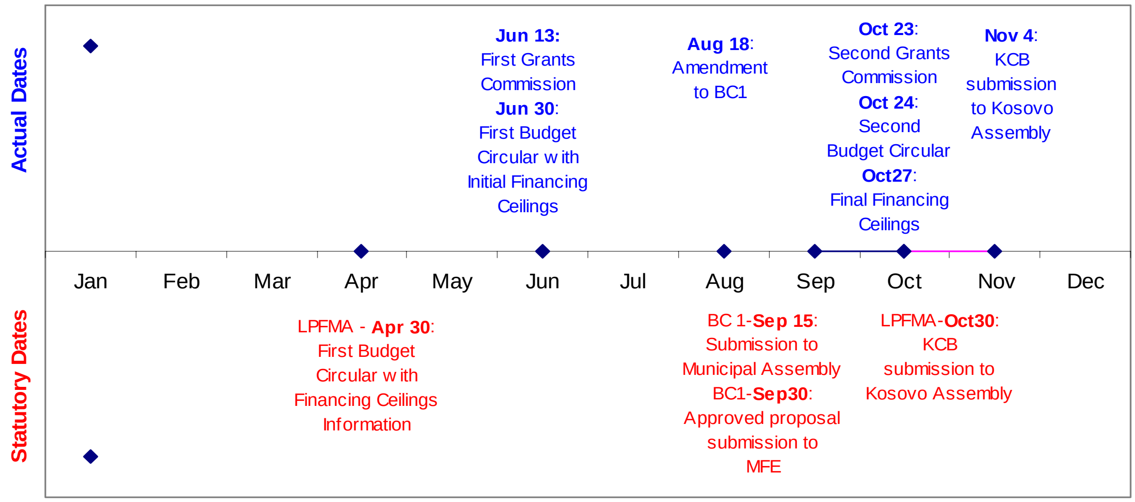
During the 2009 Municipal Budget preparation, the MFE communicated with municipal Budget Organizations through a series of Budget Circulars, which provided Municipalities with general budget instructions, the budget development timetable, information about financing from central government transfers, and expenditure ceilings. The first Budget Circular, which included initial estimates of transfers, was issued in June. It represented a later budget commencement compared with the budget calendar established in the LPFMA. This delay was mainly attributed to the need to finalize the 2009-2011 MTEF and the organization of the July Donor Conference. The first Circular was followed by additional communication from MFE on the level of municipal financing allocated from government grants through (a) the second Budget Circular instructing on the finalization of the municipal budget process; and (b) the amendment to the second Budget Circular including final financing and budget expenditure ceilings. This was issued on October 27. According to the municipal budget calendar (included in the LPFMA and MFE annual circulars) Municipalities finalized their budget proposals by September 30 based on preliminary grants estimates, which proved to be unreliable. Information on final grants financing, which differed from preliminary estimates in

[11] Part III of the LLGF establishes rules for the determination and distribution of government grants, including unconditional General Grant, and two Specific Operating Grants for Education and Health.

[12] See MFE website for the Grants Commission Policy Papers and Budget Circulars, which provide description of grants formulae and approved allocation to individual municipalities.

terms of amounts and structure, was provided to Municipalities almost one month after the statutory deadline for municipal budget process completion.

Figure1. The 2009 Municipal Budget Process Timetable



Determination of final transfers and allocation principles was disturbed by ad hoc last-minute policy decisions, which weakened objectivity and transparency of grants allocation. These were vetted and officially approved by the Grants Commission and the overall impact was not significant. However, it will still be important that the authorities ensure that the LLGF rules are applied fully and transparently in the future. Thus, the 2009 Municipal Budget process demonstrated weakness in the central budget authorities' dissemination of reliable and timely information on municipal financing which affected the municipal budget process. It will be crucial that the MFE respects all aspects of the municipal budget timetable in order to ensure that municipal officials commence the budget process in a timely manner and have sufficient time to perform all required internal procedures at all stages of the budget development. It is also imperative that the Municipal Assemblies are able to review and approve the municipal budget proposals and are allowed to follow the statutory timeframe (including citizens' participation).

Score D

(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.

Municipal Budget formulation, execution, and reporting are handled within a single Financial Information Management System. Municipalities own revenues are consolidated within the Single Treasury Account; budget execution is subject to rules similar to central government Budget Organizations, while budget reporting is subject to single chart of accounts.

Municipal fiscal information is consolidated into regular reporting performed by the Treasury Department, including quarterly budget execution reports and annual financial statements.

Score A

PI-8	Explanation	(Score-M2)
(i) Transparent and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations);	**Score A** (i). The horizontal allocation of almost all transfers (at least 90% by value) from central government is determined by transparent and rules based systems.	
(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year;	**Score D** (ii) Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable.	**B**
(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.	**Score A** (iii) Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.	

3.2.5 PI-9 Fiscal Risk

(i) Extent of central government monitoring of AGAs and PEs.

There are two categories of Public Enterprises: Socially Owned Enterprises (SOEs) which are under the auspices of the Kosovo Privatization Agency (KPA) and Publicly Owned Enterprises (POEs) which are required to report to the POE Policy and Monitoring Unit in the Ministry of Finance and Economy. POEs include utility-type enterprises – Airport, Post and Telecommunications, Electricity Company, Water, Radio and Television, District Heating, and Water and Irrigation. There are 26 POEs in total, and they are individually audited by independent Auditors, and any issues are summarized in the OAG's annual audit report on the KCB.

The distinction between SOEs and POEs relates to how they were created under the Law on Enterprises that was in force prior to June 1999, and, for POEs, their subsequent definition as a POE under a Law promulgated since June 1999.

Socially Owned Enterprises are the commercial enterprises that were collectively owned under the previous regime. For example, land, shops, buildings, farms and businesses and are slated for privatisation[13]. While the SOEs report regularly to the KPA (on a quarterly basis) and those SOEs under direct administration by KPA are audited, a consolidated report of all SOEs is not produced and there is no report on overall fiscal risk.

The POEs are not currently in the practice of reporting to the MFE, in part reflecting that the POE Monitoring Unit is only newly established and new corporate governance arrangements are in the process of being implemented for POEs. Nonetheless, the central government does

[13] The current privatization "Wave" in number 34 published 14 April 2009.

closely track the fiscal risks in the ownership of POEs and it includes an analysis of POE issues in the Fiscal Risks and Sector Strategy sections in the MTEF.

Most of Kosovo's autonomous government agencies operate their finances through the Single Treasury Account and are included in the Treasury's regular reports. Some autonomous bodies, including the central bank and government media (such as the RTK) operate outside of the Treasury and report directly to the Assembly, such that their finances are not included in the consolidated financial statements.

Score C

(ii) Extent of central government monitoring of SN governments' fiscal position.

The legal framework in place does not allow local governments to enter into any debt obligations, and thus to generate fiscal liabilities for the central government.

The Debt Law, currently in a draft form and expected to be promulgated in 2009, will regulate responsibilities, criteria, and limits for municipal debt. In principle, it is foreseen that municipal debt shall be subject to a prior written approval of the MFE, while such approval shall not constitute a guarantee, or in any way establish any liability of the Government for the payment of the debt. Thus, municipal debt will not represent a direct or indirect obligation of the Government unless the Minister of the MFE issued a written guarantee.

All municipalities channel all of their funding (except grants from the Serbian Government) through the Single Treasury Account. The fiscal position of local governments is monitored and reported on a regular basis and consolidated in the monthly and quarterly fiscal reports prepared by Treasury. Furthermore, local governments report Financial Statements to Treasury on an annual basis. In general, due to the structure of municipal financing (i.e. from government grants and Own Source Revenue) and lack of access to borrowing, municipalities have been generating positive balances until recently.

Score A

PI-9	Explanation	(Score-M1)
(i) Extent of central government monitoring of AGAs and PEs.	**Score C** (i) Most major AGAs/PEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete	C+
(ii) Extent of central government monitoring of SN governments' fiscal position.	**Score A** (ii) The net fiscal position is monitored at least annually for all levels of SN government and central government consolidates overall fiscal risk into annual (or more frequent) reports.	

3.2.6 PI-10 Access to Fiscal Information

(i) Number of the above listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met).

Public access to key fiscal information is assessed through the six criteria for the indicator as follows.

(i) Annual budget documentation

The 2009 annual Budget Law was approved by the Assembly and was promulgated on time. The 2009 budget book, containing the macro-fiscal framework, descriptions of sector strategies, the LPFMA, the budget schedule, and an expenditure report for the first 9 months of 2008, was submitted to the Assembly in addition to the draft annual budget law. The annual law is normally available to the public through the official gazette. However, the 2009 budget law was not made available to the public as amendments were presented by the Government, which required it to be returned to the Assembly for review.

(ii) In-year budget execution reports:

Following section 45 of the Law 03/L-048 on Public Financial Management and Accountability, the MEF prepares quarterly, mid-year and 9-month reports on in-year budget execution (2008 is an example). These reports are available to the public and can be found in the MEF webpage: www.mfe-ks.org Financial Statements - reports.

(iii) Year-end financial statements

Pursuant to section 46 of the Law 03/L-048 on Public Financial Management and Accountability, the MEF is obliged within three months after the end of calendar year, to prepare budget execution summary reports. The 2007 financial statements are prepared within the deadline and were made available to the public after the completion of audit, and can be found in www.mfe-ks.org – financial statements – 2007 Annual Financial Report. The 2008 Financial Statements were signed by the Minister and Head of Treasury on 26 March 2009.

(iv) External audit reports:

According to Section 47, Item 47.3 of the Law on Public Financial Management and Accountability, the Office of the Auditor General is obliged to prepare a report on financial statements of Budget Organizations and Publicly Owned Enterprises within seven months after the closing of fiscal year, and to submit the same to the Assembly by 31 July.

The Office of the Auditor General has prepared a report on the 2007 Financial Statements and has made this available to the public with 3 month delays (November). Such report can be found in OAG's webpage: www.ks-gov.net/oag - BKK - 2007.

(v) Contract Awards

Section 82.2 of the Law 03/L-099 on Public Procurement stipulates that an annual report containing analysis of public procurement activities in Kosovo is prepared and submitted to the Government and Assembly. Quarterly reports on contract awards are also prepared. All contracts are public, including those with value above €100,000 and can be found in PPRC webpage: www.ks-gov.net/krpp - Published Notices - Archives - Contract Award Notices

(vi) Resources available to primary service units:

Following any new year's budget approval, all central and local spending agencies are made aware of their resources but not at the lowest primary service levels. The budget planning in the Budget Development Management System (BDMS) is carried out only at programme level. Changes to the chart of accounts in KFMIS were made in 2008 to facilitate budget planning at primary service units, but are yet to be used

Access to fiscal Information

	Information	Availability
1	Annual budget documentation	X
2	In-year budget execution reports	√
3	Year-end financial statements	√
4	External audit reports	√
5	Contract awards	√
6	Resources available to primary service units:	X

PI-10	Explanation	(Score-M1)
(i) Number of the above listed elements of public access to information that is fulfilled	**Score B** The government makes available to the public 3-4 of the 6 listed types of information	**B**

3.3 Policy-based budgeting

3.3.1 PI-11 Orderliness and Participation in Budget Process

(i). Existence of and adherence to a fixed budget calendar.

Section 20 of the Law on Public Financial Management and Accountability authorizes the MFE Minister to issue one or two budget circulars on budget planning by April 30, containing instructions regarding expenditure ceilings for the next fiscal year and estimates for two subsequent years. A defined budget calendar is established at the start of the budget process, which is communicated to BOs.

Three budget circulars at the central level and two at the municipal level were issued for the 2009 budget planning cycle. The first central level budget circular was issued on 13 June 2008, the second on 4 September 2008 and the third on 14 October 2008. The first budget circular for municipalities was issued on 30 June 2008 and the second on 24 October 2008. These circulars set out the budget process timetable. BOs have complied with timelines set out in the first budget circular with a deadline set for 30 June 2008. The deadline set out in the second circular was 18 September 2008 and more than 90% of BOs made their submissions on time. The deadline set out in the third budget circular for submission of budget request was 17 October 2008 and the majority of BOs have submitted their request on time. At the municipal level, all municipalities have complied with deadlines, with exception of Pristina Municipality.

Score B

(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent).

The fiscal year is the same as the calendar year, which runs from 1 January to 31 December.

The information contained in the budget circulars is as follows:

- The first budget circular for the central level contains Government priority policy, key MTEF elements as an aspect of budget development guidance for BOs, initial current spending ceiling at BO level, and the 2009 – 2011 budget preparation calendar.
- The second budget circular for central organisations contains hard ceilings for current and capital expenditures, the deadline for budget submissions, and the budget hearing schedule.
- The third budget circular for the central level contains the final ceilings approved by the Government cabinet.
- The first budget circular for municipalities contains initial instructions on budget preparation, the calendar, and initial ceilings for the 2009-2011 municipal budget preparation.
- The second budget circular for municipalities informs the municipalities of the final allocation of government grants and provides instructions on procedures for completion of the 2009 municipal budget process.

However, there were three elements, which affected the scoring of this dimension

- The expenditure aggregates contained in the MTEF were changed two weeks after its publication;
- The Cabinet did not deliberate and approve the ceilings prior to the second circular being sent out to the BOs; and
- Substantial changes to expenditures were made for BOs after the issuance of final ceilings.

Score C

(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years);

The 2007 budget was approved before the start of fiscal year, whereas the 2008 budget was approved 2 months late due the request from the newly elected government to give them the opportunity to review the proposed budget more completely, and the 2009 budget was approved before the start of fiscal year.

Score B

PI-11	Explanation	(Score-M2)
(i) Existence of and adherence to a fixed budget calendar;	**Score B** (i). A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time	B
(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent);	**Score C** (ii) A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by Cabinet only after they have been completed in all details by MDAs, thus seriously constraining Cabinet's ability to make adjustments	
(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years);	**Score B** (iii). The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.	

3.3.2 PI-12 Multi-year Perspective

(i) Preparation of multi -year fiscal forecasts and functional allocations;

The 2009 - 2011 MTEF document presents a three year (on an annual basis) forecast of domestic revenue and expenditures, but not yet on a rolling basis. The additional financing of expenditures over and above those from domestic revenue (the financing gap) is also presented. This contains a line, which specifies the residual financing needs (both on-and off-budget) on an annual basis over the MTEF period, as well as an exposition of donor financing support broken down into on-budget needs and off-budget (capital and technical assistance) expenditures. The MTEF also provides an overview of the composition of expenditures by function but does not project this into the MTEF future horizon. It does, however, present the projected annual expenditure for broad sectors over the MTEF period broken down by operational and capital categories with the latter further broken down by projects that are funded in the MTEF or need to be funded by donors as either "priority" or "other". These sectors may correspond to a ministry if a sector is covered by a single ministry (such as health), but may also encompass several ministries (as in Law Enforcement).

However, the 2009 - 2011 MTEF document was prepared and published in June 2008 as an input to the setting of the ministerial resource ceilings and in preparation for the July Donor Conference. It has differed from the subsequent budget figures in December 2008, which have incorporated an update of the macro-fiscal framework and the outcome of the budget negotiations. The differences are not explained in the subsequent budget documentation, which is the first year of the MTEF period.

The ceilings presented in the second budget circular were multi-year in nature and the PIP system was set-up to accept multi-year projects and multi-year ceilings. The budget document submitted to the Assembly contained forward estimates of the capital projects funded in 2009. However, the forward estimates of recurrent programmes and funding of new capital projects planned for future years were not presented in the budget documents.

Score C

(ii) Scope and frequency of debt sustainability analysis

At present Kosovo does not contract debt due to its fiscal position and the prior legal impediments associated with Kosovo's status. However, there is a forecast of potential debt liability under the settlement with Serbia in the MTEF. Nevertheless, work has been carried out in the Ministry of Finance and Economy to develop the capacity for a debt strategy and debt sustainability analysis. Due to the potential debt that may emerge from the negotiations over Kosovo's independence from Serbia, a debt analysis was carried out in 2008. Appropriate debt analysis software has been installed and is operated by the Cash Flow and Debt Management Department, the unit responsible for debt in the MEF.

Score B

(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure;

The MTEF document presents a mission statement and description of the existing situation, and goals for the various sectors, but these are not uniform in quality or clarity. More comprehensive sector strategies are being developed under the EC-funded KDS project, which is currently working with 4 ministries. Currently only the agriculture sector strategy is fully completed. There is a strategy for health, but this has not been costed nor elaborated in terms of implementation in relation to the MTEF or annual budget. These sector strategies are driven by the EC- funded project supporting the KDS with sectoral ministry input, and reflect the much stronger analytical capability in the KDS project, which consists of consultancy support. The sectoral ministries would probably not be able to produce such a sector strategy independently.

This reflects a weakness in the sectoral ministries in planning and budget preparation. The capacity to formulate ministerial budgets linking policy to plans and plans to budget formulation is still underdeveloped and has to be the next step in the evolution of Kosovo's MTEF process.

Score C

(iv) Linkages between investment budgets and forward expenditure estimates.

Kosovo has a Public Investment Programme (PIP) under which investment projects are assessed as to potential viability. In principle, each investment priority is analysed as to its financial requirements and available funding over the construction phase as well as the recurrent cost. In general, the recurrent cost implications are not factored into subsequent budgets and the lack of a coherent sector strategy means that projects are developed in isolation. Indeed, there are cases of health projects that have been implemented but later being closed down because the budget was unable to support the necessary operating costs. The PIP is not integrated into the MTEF and is in effect a centrally driven list of projects.

Score D

PI-12	Explanation	(Score-M2)
(i) Preparation of multi -year fiscal forecasts and functional allocations; .	**Score C** (i). Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling basis	C
(ii) Scope and frequency of debt sustainability analysis	**Score B** (ii) DSA for external and domestic debt is undertaken at least once during the last three years	
(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure;	**Score C** (iii) Statements of sector strategies exist for several major sectors, but are only substantially costed for sectors representing up to 25% of primary expenditure	
iv) Linkages between investment budgets and forward expenditure estimates.	**Score D** (iv). Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared	

3.4 Predictability and control in budget execution

3.4.1 PI-13 Transparency of Taxpayer Obligations and Liabilities

(i) Clarity and comprehensiveness of tax liabilities

Tax revenue is collected through two separate departments with their own tax laws. The Law on Tax Administration and Procedures was harmonized to comply with EU Legislation beginning 2005, including Corporation Income Tax, Personal Income Tax, and Value Added Tax. Amendments were enacted in 2008 for direct taxes and amendments are being drafted for VAT to comply with EU 6th directive for VAT. Kosovo Customs' legislation and procedures are determined by the Customs Code and Excise no. 03/L-109, which has replaced the UNMIK Regulation 2004/1. Kosovo Customs is authorized to collect VAT for the imports of goods; and therefore, the law on VAT no 03/L-114 is applicable and implemented by Customs. Excise tax is paid on certain goods with the rates and products defined by legislation in force. The Law on Customs clearly defines the cases and conditions for which is allowed the exemption of import duties. There is no provision for discretionary exemptions.

The various tax laws are published and can be downloaded from the Government website.

Score A

(ii) Taxpayer access to information on tax liabilities and administrative procedures.

In TAK HQ, taxpayer services are managed by the Unit for Taxpayers Education. There is also a taxpayer services department within the Unit for Large Taxpayers and in all regional offices. Currently, attention is given to producing guides for taxpayers to inform them of their rights and obligations, in order to improve taxpayer services. During 2007, a Kosovo Taxes Manual (questions, answers, and examples) was prepared.

Taxpayers have access to information from TAK through an Internet website. There are also specific seminars and different conferences to inform taxpayers on their rights and liabilities. TAK continuously holds media campaigns through education programs using TV shows, leaflets, announcements in newspapers and other materials in order to raise awareness of taxpayers on their obligations. It also periodically informs taxpayers of timelines and legal amendments and about TAK activities and steps that have been and planned to be taken on compliance.

TAK is making an effort to establish a programme for taxpayer services that will provide quick and accurate answers regarding requests/questions via visits to regional offices, by phone or in writing.

TAK plans to create a business plan for taxpayer services to define goals and standards for service performance that will be measured and used as feedback for improvement of service delivery. In developing a comprehensive strategy for taxpayer services, TAK intends to pay attention to international practise relating to taxpayer/client services.

With respect to Customs, importers have access to comprehensive information that provides the Customs Code (Article 17) to ensure that each person can seek information from Customs regarding the application of customs legislation applicable to a specific import or export. Taxpayers and other persons may seek any information through e-mail or through delivering an e-simple form with the required information. Information offered as advice during a year is summarized and published in a book at the end of the year, which is distributed free. In addition, Customs of Kosovo, upon written requests made by the various entities in conformity with Article 18 of the code, issues information on the obligatory tariff and origin.

In case of changes in laws or issuing a new law, frequent meetings with taxpayers are held where reviews of the amendments and rights and obligations, ways of law enforcement, etc. are presented. Such co-operation is usually through the Economic Chamber of Kosovo and the Kosovo Business Community.

Taxpayers may also have access to information relating to customs duties and procedures, which are posted on the web page, where all applicable laws and regulations can be found. In addition, the website has information on customs procedures and other information. This is regularly updated by Customs.

Kosovo Customs also publishes various brochures, which are distributed free to educate and raise awareness among taxpayers about their obligations.

An IMF report on *Improving Tax Policy and Tax Administration* dated September 2008 states that taxpayer confidence in the tax administration is low because of inconsistent and low- quality interpretation of the law. Businesses require certainty about the tax consequences of their transactions before they will invest significantly in Kosovo. They also need to be assured that: (i) interpretations of the law will be provided on a timely basis; and (ii) that administrative decisions will be applied consistently both throughout the TAK's regional offices, and over time. The IMF report concludes that the processes and staff within the TAK are not meeting the requirements of the legislation or good tax administration practice. Specifically it found that: (i) there is no dedicated unit in headquarters for the provision of public and binding rulings and advanced interpretations of the law; (ii) taxpayers advise that staff are reluctant to provide written rulings; and (iii) staff are said to lack the skills to interpret the law.

While at first sight, the taxpayer services and the information provide may well warrant an A or B score, the conclusions of the IMF report points to serious deficiencies in this regard which downgrades the score to a C.

(iii) Existence and functioning of a tax appeals mechanism.

Initially taxpayers should file complaints in the taxpayer complaint department of TAK. If taxpayers are dissatisfied with results of the (internal TAK) review they can submit their respective complaint to the Independent Review Board (IRB). If a taxpayer is still dissatisfied with the conclusion of the IRB, the case can proceed to court. These procedures are based on Law Nr. 2004/48 for Tax Administration and Procedures, which establishes the complaints mechanisms as well as the scope, duties and competencies of the department, which has been functional since 2000 when the TAK was established. The taxpayer has 60 days to file a complaint, and the complaints unit has 60 days to respond with its decision[14]. The decision is final as far as TAK is concerned. There are 11 staff in this department, of which 7 employees are directly involved in case review, and 1 employee is a legal officer who deals with compilation of decisions after the complaint is reviewed.

There is also a lawyer, who coordinates work with the Independent Review Board as the second review of complaints. There is one civil officer, who maintains the archive. In addition, there is a manager, who reports directly to TAK general director.

During 2006, 2007 and 2008, there were 1,683 complaints (including 402 cases submitted after the deadline, requests regarding official specifications, mandatory meetings documents,

[14] The amendment to the law dated 10th of February 2009 reduces the deadline for taxpayers submitting complaints from 60 to 30 days for both TAK and IRB. The timeline is counted from the moment when the complaint is submitted and the time of the case review to the moment when the decision is issued. The 30 days brings the time in line with Customs.

complaints that were wrongly addressed, etc). Eighty-two complaints were carried over from 2005 to 2006.

The results given in percentage for the reviewed complaints are:

- 73.8% negative decisions for taxpayer
- 2.0% completely approved decisions for taxpayers
- 11.1% partial approved decisions for taxpayers
- 13.0% cases are brought back to re-controlling

831 complaints were taken further to the IRB where

- 67.3% negative decisions for taxpayer
- 15.5% completely approved decisions for taxpayers
- 9.3% partial approved decisions for taxpayers
- 7.6% cases are brought back to re-controlling
- 0.4% others

All but 1% of the cases were reviewed within the timeline allowed by the legislation.

Kosovo Customs publishes a booklet entitled Guide on Making a Compliant, which is available from its website. The appeal system in Kosovo Customs is based on Section 291 of the Code of Excise and Customs, which allows each person to exercise the right to ask for reconsideration of the decision brought by the customs authorities when applying the customs legislation. The appeal will initially be dealt with within Customs. The party has the right to appeal to the Independent Appeal Board if not satisfied. During 2008, Customs received a total 2,134 request for reconsideration, which were reviewed in accordance with the law and relevant decisions were taken. In 200 cases, dissatisfied parties filed an appeal against the decision for review at the second level body (the Independent Review Board). The total value of the contested cases was €5,855,293.67.

If a taxpayer is still dissatisfied after receiving the findings after the second stage of the Appeals process, the taxpayer may escalate the case to the courts. According to the IMF report, in 2006 the TAK appealed 33 of the 83 cases not wholly decided in its favour. The IMF report states, "Anecdotally, we have been informed that it can be several years before cases taken to the courts are resolved. Payment of tax liabilities under appeal is suspended until the case is finally resolved, but two-way interest is payable following the decision".

The TAK has concluded that these data indicate that mechanism of complaints within TAK is considered fair, transparent, and effective. However, the IMF report points in a different direction. It states "accountants expressed concern that the TAK internal appeals process lacked integrity in that very few decisions were made in the taxpayer's favour, but were generally supportive of the IRB. However, overall, the mission considers the whole disputes resolution process is well designed and appropriate for Kosovo. The time limits for making decisions at the first two levels are reasonable, essentially guaranteeing a decision from both levels with 12 months. The mission is surprised at the low level of decisions being made in favour of the taxpayer, but attributes no special significance to this, as the position is broadly similar for both the internal and independent reviews, although it could be an indication of taxpayers misusing the system to delay payments".

At first sight, this dimension may appear to warrant an A score, but there are issues raised in the IMF report which would downgrade it. The IMF recommends an investigation for the reason for the high rate of taxpayer appeal and the low taxpayer success rate. Until this is carried out, a B score may be more appropriate.

PI-13	Explanation	(Score-M2)
(i) Clarity and comprehensiveness of tax liabilities	**Score A** (i). Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved	B
(ii) Taxpayer access to information on tax liabilities and administrative procedures.	**Score C** (ii). Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date.	
(iii) Existence and functioning of a tax appeals mechanism.	**Score B** (iii). A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed	

3.4.2 PI-14 Effectiveness of Measures for Taxpayer Registration and tax Assessment

The scoring in this Indicator is based on the weakest aspect of TAK and the Customs Administration even though one agency may be relatively stronger than the other.

(i) Controls in the taxpayer registration system.

TAK is dependent on the Ministry of Trade and Industry's (MTI) Agency for Business Registering database. Integrity of business registry information continues to be a serious issue because of a lack of effective verification procedures in the MTI. However, the Amendment to Law Nr. 2004/48 for Tax Administration and Procedures, which came into force on 11th of February 2009, enables TAK to register and de-register all taxpayers through issuance of fiscal numbers for all categories of subjects that have businesses in Kosovo and at the same time, it enables to TAK to maintain a suitable and updated registry.

This amendment will allow the regulation of procedures and criteria that need to be applied for the issuance of fiscal numbers for each person that is obliged to pay taxes in Kosovo. It also defines possible sanctions in cases when subjects do not apply and thus they fail to be equipped with a fiscal certificate. A project to issue fiscal numbers is due to start during 2009.

With respect to Customs, the MTI system is also used, but Customs issues import/export certificates for custom agents as well. Customs state that it has organized meetings with TAK and MTI to discuss problems with registration as several businesses are registered with an identical name, or have made minor changes in the registered name and the same owner (subject) became a “new” entity for various reasons.

The IMF tax report is highly critical of the dependence on the MTI system and has stressed that the accurate registration of taxpayers and the creation of a high-integrity taxpayer master file has to be major task in developing improved tax administration.

A previous IMF mission had pointed to a number of serious shortcomings with the taxpayer registration arrangements in Kosovo; particularly the reliance on the MTI business registration system for tax administration purposes. Problems presented by these arrangements included: (i) poor integrity of the MTI data, which was not subjected to a sufficiently rigorous verification process; (ii) lack of systematic updating of the MTI data at the TAK; (iii) lack of compliance measures to ensure businesses actually fulfilled their registration obligations; and (iv) allocation of business registration numbers for each business activity, with the result that individual taxpayers often had multiple numbers. To redress these shortcomings, the mission recommended, inter alia, that TAK establish its own full-fledged taxpayer registration function and use MTI data only for crosschecking purposes.

The most recent mission noted that TAK continues to rely on MTI for registration of taxpayers through the business registration process and the IMF recommendation has not been implemented. Instead, TAK efforts are focused on improving the future information flow between MTI and TAK by increasing the information captured by MTI as part of the business registration process to better meet the needs of the Tax Administration and introducing better automation to facilitate the information flow.

Score D

(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

Within current laws and tax policies relating to TAK procedures there are sanctions for not declaring and not paying taxes on time. For Customs, penalties for incorrect statements are regulated by provisions of the Custom and Excise Code (since 11/11/2008). Confiscation measures for goods is reserved only for specific cases, whereas minimum fines for custom offences (when value of goods is over €500) range from €5,000 to €10,000. For the three last years, the following results were achieved

	Value of confiscated goods	Administrative fines	Selling of confiscated goods
2006	€1,399,915.18	€131,568.65	€146,058.00
2007	€549,434.69	€115,321.20	€741, 507, 69
2008	€556,142.48	€265, 31,69	€1,217,415.00

Customs, however, consider that penalties are low and ineffective for those who under-declare at the time of import or through post clearance audits even though the nominal fine is sufficiently high. This is due to delays from courts in executing decisions on collection. The situation is made more difficult because importers who, in order to avoid payment of custom liabilities, continue their business through newly registered companies legitimately registered by other persons that are equipped with new business numbers (from MTI), new VAT certificates (from TAK) and new export-import certificates.

Score C

(iii) Planning and monitoring of tax audit and fraud investigation programs.

Every year, the Tax Administration compiles an audit plan with the number of tax audits for the year. The plan is compiled by the Department of Control within TAK HQ, in coordination with regional offices. Audit plans are prepared based on a model of resource allocation that was prepared in TAK. During 2008, 2,728 tax controls for all kinds of taxes were preformed.

Based on Kosovo tax legislation, self-assessment prevails for all kinds of taxes. Risk analysis is applied to select cases for audit. The amendments to the Tax Law in 2009 envisage the establishment of a specific Unit for Tax Investigations to deal exclusively with cases where evasion and fraud are suspected.

An electronic Systematic Assessment Programme to assess risk has been developed to select companies for audit. This programme was used at the end of 2008 for preparing a audit plan for year 2009. The Department Control within Headquarters will select 20% of companies to be audited in 2009[15], mainly through using this electronic IT system, which will also serve to test the effectiveness of the software. This will be the first time that regional offices do not select cases for audit.

With respect to Customs, software in use includes a risk assessment module, which determines the volume of physical examinations of Import-Export shipments depending on the risk profile of each importer or exporter. One of the criteria that determine which entities will be subject to post-importing audits is also risk assessment. Figures of collections from post-import audits are:

2006	€4,682,114.26
2007	€2,512,252.68
2008	€973,664.60

With respect to tax audits, the most recent IMF mission notes that audit issues have been consistently identified in many of its reports. It notes that the audit function is not actively managed from headquarters. The current role of staff in headquarters is primarily to provide the field with a centralized support and advisory function on issues such as technical guidance in complex cases; training and field support; approval of refund applications; and conducting complex evasion audits. In general, the headquarters staff do not provide a policy direction, control and monitoring function. The nature of the annual audit plan provides a good example of how this approach is manifest. The plan is a well-designed document with input from both headquarters and the field, but it appeared to the mission to be more concerned with reflecting the levels of audit, which the regions believed they could deliver instead of directing the program in the direction chosen by senior management. The headquarters' audit function and the role of its staff need to be comprehensively reviewed. Headquarters staff

[15] A February 2009 IMF mission suggested that this should be increased to 30%.

should not be involved in technical issues such as refund clearance, complex case management and technical support, but should be dealing with issues such as: (1) developing audit strategies; (2) specifying and regularly updating the case selection criteria; (3) developing effective quality based performance standards, and monitoring regional performance; (4) identifying emerging auditing and accounting trends; (5) improving auditing systems and procedures; (6) assisting with the development of training needs.

The mission noted that there is inadequate attention given to research and risk analysis. Because of the lack of appropriate staff at headquarters, there is no effective research and risk analysis activity. Some good data is being gathered on a regular basis from Customs and in a more ad hoc way from the police and other investigatory bodies. This data is available for the regional offices to assist in their audits. Nevertheless, there is no structured review of organizational compliance risks, and no capacity to identify and anticipate emerging compliance trends or to develop new approaches to deal with such developments. Two specific aspects of the lack of capacity to assess and manage risk warrant mention.

- *Case selection.* Although work appears to be well advanced on the development of an objective audit-case selection system, at the time of the IMF's mission, cases were still being selected at the regional level at the discretion of the local manager. The mission strongly supported the development of the objective risk-based case selection system and urges its implementation.
- *Allocation of auditors.* Auditors are allocated more or less evenly between the regions irrespective of the differing levels of compliance risk. The allocation of staff requires reconsideration once a risk assessment capability is developed.

Score C

PI-14	**Explanation**	**(Score-M2)**
(i) Controls in the taxpayer registration system.	**Score D** (i) Taxpayer registration is not subject to any effective controls or enforcement systems	**D+**
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations.	**Score C** (ii). Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance	
(iii) Planning and monitoring of tax audit and fraud investigation programs.	**Score C** iii) There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria	

3.4.3 PI-15 Effectiveness in Collection of Tax Payments

(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).

The OAG report for 2007 notes that TAK showed that, based on self-evaluations results on 31 December 2007, uncollected tax revenues were in amount of €235,329,034. This amount is higher than the value of tax revenues realized in 2007 by TAK. This amount includes uncollected revenues from previous years and for 2007. Thus, on 01 January 2007 uncollected revenues amounted to €196,788,428 and increased by €38,540,606 in 2007 alone.

Customs procedures require that applicable taxes must be settled before goods are released. Arrears are generally generated by fines that are levied on importers. However, audited importing companies owe Kosovo Customs € 22.8 million, of which KEK owes €20.8 million, which relates to taxes on imported electricity from 1st January 2004 to 31st October 2008.

Even if Customs arrears in 2007 were zero, the €38.5 million increases in TAK arrears in 2007 amounted to 4.4% of tax collected. Total arrears are increasing rather than decreasing so new arrears are greater than arrears collected.

Score D

(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.

Payments by taxpayers are paid into commercial banks (except public institutions, which pay into the Central Bank of Kosovo). These payments from commercial banks are reported to the Central Bank, which later are transferred to the TAK bank account in the Treasury. Transfer of these payments by commercial banks should be done within 48 hours. Customs reports that payments for public institutions (after paying the customs duty) is made into the Treasury (in the government accounts at the Central Bank) and the transfer from commercial banks to CBK for payments Customs is made within 24 hours.

This is consistent with PI-22.

Score A

(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.

Reconciliation of revenues from commercial banks as in the case of TAK is done on a daily basis, whereas full reconciliation with the Treasury is done on a monthly basis. Reconciliation with the Treasury is done by fourth day of following month.

Revenue reconciliations (collected by Customs) with commercial banks and the Treasury through the Central Bank are carried out on a daily basis and the final reconciliation is done each month with Treasury. A revenue report is presented on a weekly and monthly basis.

This is consistent with PI-22.

Score A

PI-15	Explanation	(Score-M1)
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year	**Score D** (i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections).	D+
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	**Score A** (ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily.	
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.	**Score A** (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month.	

3.4.4 P-16 Predictability in the Availability of Funds for Commitment of Expenditures

(i). Extent to which cash flows are forecast and monitored.

The Division of Cash Flow and Debt Management (DCF&DM) within the Treasury monitors and executes the budget. It monitors revenues and expenditures, forecasts cash (both flow and stock), manages debt, and preserves budget liquidity. DCF&DM manages allocations through the year to ensure that the budget is executed within the available cash amount. This function is managed through the forecasting of cash flow stock by the Treasury and BO, as well as monitoring of revenues and expenditures.

At the beginning of the fiscal year, DCF&DM generates projections of revenues and expenditures to forecast cash flow. These projections are based on historical data of the last three years extracted from KFMIS, the forecasts of GDP, and the anticipated inflation rate This projection is carried out though a comparison of each month with the previous year's actual monthly revenues in cooperation with Customs and Kosovo Tax Administration. DCF&DM also prepares monthly forecasting updates, and carries out an analysis of deviations between actual and forecasts.

At the beginning of each fiscal year, the Treasury issues an Administrative Directive to guide budgetary organizations in preparing their cash flow plan, which sets a deadline for the submission of the plan to the Treasury.

In Kosovo, there has been no shortage of cash to implement planned budgets so there has been no requirement for DCF&DM to adjust these within the year based on actual cash flow. However, in such a situation of cash shortage, monthly allocations would be adjusted in the light of any cash shortage.

Score A

(ii) Reliability and horizon of periodic in-year information to LMs on ceilings for expenditure commitment

The Treasury manages allocations through the year and controls budget execution and cash management based on the cash plan submitted by Budget Organizations themselves. These cash plans should be compliant with allocated annual appropriations for the Budget Organization according to law approved by Kosovo Assembly.

Expenditure plans are included in cash flow plans as well as BOs' Own Source Revenues plans for that respective fiscal year. Cash flow plans should be in accordance with the year's annual budget appropriation law – to ensure spending within limits for the number of staff and within limits for economic categories.

Allocations to Goods and Services, Subsidies and Transfers are made on a quarterly basis. Wages and Salaries amounts are allocated monthly to maintain control on the number of employees in relation to the approved budget. Allocation of Capital Expenditures funds is done on a quarterly basis based on expenditure plans submitted by the BO, which are presented in detail in the cash flow plan (according to the PIP). In accordance with cash flow plans submitted, BOs are able to commit expenditure for at least 6 and possibly even up to 12 months in advance within appropriation limits.

Score A

(iii). Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of LMs.

Currently there are no changes made to budget allocations that are not initiated by Budget Organisations through the submission or adjustment to their cash flow plans. The main reasons for this are the surplus of funds available in the bank and the favourable seasonality of revenues compared to expenditures, which allows surpluses within the year. The DCF&DM unit forecasts and closely monitors cash flows and allocations. In the event that adjustments to allocations were required, the Law on Public Financial Management and Accountability provides clear direction as to approval mechanisms for such adjustments of expenditures as well as their prioritisation.

Score A

PI-16	Explanation	(Score-M1)
(i). Extent to which cash flows are forecast and monitored.	**Score A.** i) A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows.	**A**
(ii) Reliability and horizon of periodic in-year information to LMs on ceilings for expenditure commitment	**Score A** (ii) BOs are able to plan and commit expenditure for at least six months in advance in accordance with the budgeted appropriations. Score A	
(iii). Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of LMs.	**Score A** (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.	

3.4.5 PI-17 Recording and Management of Cash Balances, Debt and Guarantees

(i) Quality of debt data recording and reporting

Due to the specific status of Kosovo, the Government could not enter into borrowing either domestically or internationally until now. However, in accordance with provisions of the Comprehensive Proposal for Status Settlement Kosovo is expected to assume foreign debt obligations in the near future. It is anticipated that the servicing of external debt will commence by the end of 2009. The Government, to express its commitment to assume external debt obligations, established an escrow account into which €55 million was deposited in 2008.

Kosovo authorities already undertook necessary steps to establish adequate legal frameworks and needed system for debt management. The Debt Law is now being finalized by MFE and is to be presented to the Kosovo Assembly in the second quarter of 2009. It will regulate the authority and procedures for borrowing, debt management, and guarantees for central and local governments. A Debt Management Unit was established in Treasury with appropriate staff in place. Debt management software (CS-DRMS) was purchased in December 2008. Training for debt management units in the Treasury and the Kosovo Central Bank is scheduled in the second and third quarters of 2009 after the Debt Law is passed.

The Debt Management Unit currently manages and reports government loans to the Electricity Utility (KEK) under the authority of the LPFMA and the annual Budget Law using Excel and KFMIS.

This dimension is scored as **not applicable** as currently Kosovo has not taken over any debt rather than being scored on the preparation that DCF&DM has undertaken with respect to debt (see PI-12 (ii).

Score Not Applicable

(ii) Extent of consolidation of government cash balances

The Government has created a Single Treasury Account, which is used to manage all transactions of the Government and these are consolidated on a daily basis.

Score A

(iii) Systems for contracting loans and issuance of guarantee

Pursuant to LPFMA, the Minister of Finance and Economy has the role of a Government agent and is authorized to represent the Government in its borrowing or guarantee activities. In this capacity, as an authorized Government agent, the Minister is in charge of conducting negotiations, executing any borrowing and guarantee documents, to maintain documents and all agreements.

As there is, as yet, no debt, the score is rated **not applicable**.

PI-17	Explanation	(Score-M2)
(i) Quality of recording and reporting of arrears data	**Score Not Applicable**	A
(ii) Extent of consolidation of government cash balances	**Score A** All cash balances are consolidated on daily basis.	
(iii) Loan contracting and guarantee issuance systems	**Score Not Applicable A**	

3.4.6 PI-18 Effectiveness of Payroll Controls

(i) Degree of integration and reconciliation between personnel records and payroll data.

There is no government-wide, reliable, complete personnel database. The only database in use is the payroll database and system, which also covers some functions of the personnel database. The Payments division within the MPS centrally manages this database. Each BO manages the personnel data separately.

In January 2009, new software on Personnel has been developed and delivered to the MPS. This software will be run by the Human Resources Division in the MPS, and it has been ensured that a communication exist between the two databases. It remains to be tested and ensured that these links actually work.

Score D

(ii) Timeliness of changes to personnel records and the payroll

Budget Organizations make the request to add/delete/change data of a person in the database. It is their responsibility to complete the required information on the person; also, they are responsible to ensure that once the employee leaves the job, this is reported to the central payroll division within the MPS.

MPS collects the lists from BOs until the 11th of each month. By the 18,th these data are input into the payroll database and on the 20th of the month, the payments lists are prepared, which are then circulated back to BOs to check for any potential changes or mistakes.

Due to the requirement to update the payroll monthly, prior to the execution of the payroll, the changes are made on a timely basis and retroactive adjustments to the payroll are rare.

As noted above, there is no direct link between human resource information held by individual Budget Organizations and the payroll, so that the possibility arises of large discrepancies between the two. This weakness is captured in the scoring of dimension (i) & (iv).

As Budget Organizations update the payroll monthly, prior to the execution of the payroll, the changes are made in a timely basis, and retroactive adjustments to the payroll are rare, a B Score is warranted.

(iii) Internal controls of changes to personnel records and the payroll.

Since its development, the payroll system of the MPS has required written forms to be completed for changes to the payroll, including multiple points of control. The payroll procedures then enable the amended payroll to be sent back to Budget Organizations to be reviewed before the payroll is finalized.

In 2008, the payroll software was upgraded. One of the features of the new software is the ability to record the audit trail of the changes, which ensures that any change to a particular record is recorded and can be traced back to its originator.

An ongoing issue is the lack of budgetary control in the processing of the payroll, where the sufficiency of budget allocations is not determined until the final payroll is transmitted to the Treasury for processing. In recent years, the Treasury has regularly held back payment to specific organisations due to overspending that is directly related to the lack of control of appropriations and allocations in the internal controls for payroll adjustment. Thus while internal controls exist for changes to the payroll, these do not ensure that budget allocations or staff limits are not exceeded.

Score D

(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.

In the end of 2006, the Payments Division initiated a clean-up of the database. One of the aims was to ensure that every person has an ID card number within the database. Through liaising with the Pensions Trust and Central Processing Unit, the Payroll Division ensured that all the people in the payroll database have an ID card number. Since then, the software was upgraded to ensure that new additions were not admitted to the database without an ID Card Number. Since 2007, the Payments Division in MPS runs checks on a monthly basis to ensure that people older than 65 are not paid. This is because BOs had not reported the retirement of staff when appropriate.

The Auditor General's office conducts yearly audits of the payroll system, but the last audit was conducted in 2007.

Score C

PI-18	Explanation	(Score-M1)
(i) Degree of integration and reconciliation between personnel records and payroll data.	**Score: D** (i). Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists.	D+
(ii) Timeliness of changes to personnel records and the payroll	**Score: B** (ii) Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally.	
(iii) Internal controls of changes to personnel records and the payroll.	**Score: D** (iii). Controls of changes to records are deficient and facilitate payment errors.	
(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.	**Score: C** (iv) Partial payroll audits and reviews have taken place in the last three years.	

3.4.7 PI-19 Competition, Value for Money and Controls on Procurement

Though procurement is undertaken by each Budget Organization (contracting authority), the Law on Public Procurement (LPP) under its Titles V, VI and VII provides for three central bodies with responsibilities relating to public procurement. These bodies and responsibilities are:

- The Public Procurement Regulatory Commission (PPRC), a body under the Assembly of Kosovo, whose functions include the following (Title V):
  - Preparing and promulgating secondary legislation, including manuals, guidelines, and standard bidding and contract documents;
  - Maintaining an electronic Public Procurement Register;
  - Publishing all procurement notices and notices of contract awards on its website;
  - Collecting, analyzing, and publishing data on public procurement procedures and awarded public contracts, including in an annual report to the Assembly of Kosovo;
  - Initiating the development of electronic procurement processes;
  - Contributing to the professional standards for the training and certification of procurement officers (jointly with the Kosovo Institute of Public Administration).
- The Kosovo Public Procurement Agency (KPPA), an executive body under the Office of the Prime Minister, whose functions include the following (Title VI):
  - Preparing recommendations to the government on the procurement of common or high value items that may be more efficiently procured under consolidated or common procurement;
  - Acting as the contracting authority on behalf of one or more Budget Organizations on the request of the government or of the Budget Organization(s) concerned;
  - Assisting Budget Organizations in the conduct of specific procurement activities on their request; and
  - Exercising exclusive competence to authorize procurements under negotiated procedures without publication of a contract notice and to waive the legal requirement for cancellation of procurement processes where fewer than three responsive tenders have been received.
- A Public Procurement Review Body (PPRB), a body that has yet to be established by the Assembly of Kosovo to assume responsibility for the review of complaints related to the public procurement process (Title VII).

Other central bodies with competences in the area of public procurement are the Kosovo Institute of Public Administration (KIPA), which is responsible for the training and certification of procurement officers, and the Office of the Auditor General, which has responsibility for external audit of all procurement undertaken by Budget Organizations in Kosovo.

(i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold).

Since July 2007, PPRC started to publish contract announcements in the web.

The 2007 report presented public procurement divided according to procedure types and the value of signed contract, number, and to the value of signed contract according to opened competition procedure. The value of open competition procedure is €326,326,955.34 or 80.93%, of total contracts valued at €402,228,436.90.

Year	Total value of signed contract for all kinds of procedures	Value of signed contracts according to opened procedures	Percentage of participation in total value
2007	€402,228,436.90 .	€326,326,955.34	80.93 %

Taking into account dimension (i) the value of contracts with opened procedure exceeds the 75% figure, an A score would be appropriate. However, a September 2007 World Bank report Opportunity for Public Procurement Quick Gains – Preliminary Analysis concluded "Public tendering does not sufficiently reach the market. The tender documents and the requirements for qualification set therein are too complex and probably too ambitious regarding the obligatory requirements for participation in the tender procedure (financial, technical, and professional criteria). The market is not sufficiently prepared to reply to these complex and ambitious requirements." Another relevant reason is the strict law requirement to have at least three eligible tenders after evaluation. In exceptional cases, the contracting authorities can request from the PPA approval to award a contract without having a sufficient number.

In the year 2008, PPA has received 253 such requests, whereas 118 of the requests were rejected. For the first half of 2008, (i.e. January until June 2008), some 33% of the tenders have been cancelled due to the non-availability of three responsive tenders. Usually these tenders are cancelled and re-tendered, which forces either the bidders to lower their bid prices or they simply do not bid again for the same tender."

The Evaluation Committees are trained to be very strict during evaluation. For example, any missing copy of a document, which was to be submitted with the bid, nevertheless its importance, leads automatically to the rejection of the bid. Evaluation Committees do usually not require any clarification or allow the bidder to file subsequently the missing document."

The report states that there has also been "several price inconsistencies in the contracts. Acc § 59 of the LPP evaluation commission is obliged to request clarification from bidders with anomalies in their prices. If their clarification is not reasonable, they are obliged to withdraw their tender. This obviously has not happened. Either these price inconsistencies have not been observed during the evaluation process, or they have been generated as part of a possible wrongdoing. Usually the evaluation committees do not crosscheck the offered prices of the different bidders in order to find these anomalies. It is strongly recommended that the evaluation committees cross check the unit price for each item and to build a median, thus allowing them to find out the unrealistic prices."

This would indicate that underlying quality behind the data would not justify the highest score, and accordingly a B score is merited.

(ii) Justification for use of less competitive procurement methods

The conditions for the use of less competitive public procurement methods are defined in the Law on Public Procurement, Regulations and other instructions. Nonetheless, use of this method was mainly by public enterprises such as KEK, PTK ANP on the grounds of unsustainable market in the context of providing specific products and services.

Article 34 of the LPP sets out the criteria for use of negotiated procedures, without any public announcement. It decisively foresees cases when this procedure can be used and it is completely in accordance with PPL requirements. Therefore, when taking into account market specific features and especially regarding products that are technically related (technical liabilities) or legally related, and when considering the aspects of "property and intellectual rights" for IT systems and the ability of the market to provide products for specific services, as well as situation of mainly old public enterprises in regard to technology, the Application of these Methods is considered to be within normal practice.

The 2007 annual report presented the percentage breakdown of these procedures, which are not through open completion as follows

1.	Negotiated procedures with no public announcement	12.44 %
2.	Post-Publishing Limited Procedure	0.44%
3.	Prices Quoting Procedure	5.15%
4.	Minimal Value Procedure	0.75%

The application of less competitive procedures is considered to be used only in specific cases (as foreseen by PPL) and it is showing a decreasing trend as a result of increased effectiveness in Procurement Departments who have started to apply more qualitative planning. An improvement trend has been seen in recent years because of exact and on-time planning and more detailed justifications for cases of application with negotiated procedures without having contract announcement.

Score B

(iii) Existence and operation of procurement complaints mechanism

The Public Procurement Review Body (PPRB) for "Public Procurement in Kosovo" is based on amended UNMIK Regulation 2007/20, which was promulgated on 6th June 2007. It presents a significant contribution of efforts for increasing transparency and compliance for better administration of public funds, and it also is important in increasing the level of trust by companies with respect to fair and impartial competition. Meanwhile, the requirement for raising transparency and equality in public procurements is one of the conditions of Association-Stabilization Agreement between Kosovo and EU. PPRB is an independent institution that has the mandate from Assembly of Republic of Kosovo to address complaints relating to procurement.

PPRB has started with its activity on 1st August 2008. During the first five-month period, there were 179 complaints submitted, out of which 142 were successfully completed.

According to law, the deadline for review of complaints is 35 calendar days from the day when the complaint is received. Based on PPRB's first five-month all cases were reviewed and decisions are brought within the legal deadline.

Until the end of first half of year 2008, the review of complaints was carried out by the Department of Complaints-Review Committee functioning within the PPRB.

The review of complaints that are addressed to the PPRB is done by the Review Panel, which is composed of three members of the PPRB Board. The Chair of the Review Panel is appointed by Government, whereas two (2) other members are appointed by the PPRB Chair.

In 2007, the Review Panel received and reviewed 246 complaints concerning 210 procurement cases, which represented 3.16% of procurement tenders.

During six months to 30th June 2008, 110 complaints concerning 98 procurement tenders, which were claiming violations of Law by Contracting Authorities in assessing offers were received and reviewed.

Score B

PI-19	Explanation	(Score-M2)
(i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	**Score B** (i). Available data on public contract awards shows that more than 50% - 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate.	**B**
(ii) Justification for use of less competitive procurement methods	**Score B** (ii). Other less competitive methods when used are justified in accordance with regulatory requirements.	
(iii) Existence and operation of procurement complaints mechanism	**Score B** (iii). A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority.	

3.4.8 PI-20 Effectiveness of Internal Controls for Non-salary Expenditure

(i) Effectiveness of expenditure commitment controls

The public finance internal control function is defined in Law on Public Financial Management and Accountability and the Treasury Financial Rules, and is elaborated in the PFIC policy document. There are two central harmonization units: one for internal audit and the other one for Public Finances Internal Control. A PFIC Unit was established through a regulation issued in May 2006 by the Treasury.

The financial management information system (KFMIS) provides the basis for internal financial control:

- Firstly, there is control at the level when the budget is allocated for each Budget Organization;
- Secondly, there is control at the level of fund allocation, which should be in accordance with the budget allocation.

- Thirdly, there is control at the commitment stage ensuring only allocated funds are spent. The system controls commitments to ensure that they are within the budget allocation and it does not allow funds to be committed if there is no allocation.
- Finally, funds should be committed before the procurement process starts, which provides a fourth control system for public expenditure management.

At the beginning of each quarter, every Budget Organization should analyze all its potential liabilities, as well as its procurement plans in order to ensure that it has committed funds in ISKFM/SIMFK for this purpose. Good use of commitments prohibits gathering of unpaid liabilities at the end of the year (PI-4). Commitment controls for expenditures are in place procedurally and technically. However, existing outstanding obligations at the end of the year, although small as a percent indicates an element of mismanagement.

Score B

(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures

The internal control procedures are established in the Law on Public Financial Management & Accountability and the Treasury Financial Rules (subordinate legislation) and use of the Kosovo Financial Management Information System.

The internal control regime is comprehensive and highly relevant, with harmonisation achieved between the legislation, subordinate legislation and the application of the KFMIS (including procedures and manuals) through (1) the development of Treasury rules and procedures in conjunction with KFMIS implementation and (2) through ongoing revisions to the Law on Public Financial Management & Accountability.

Treasury ensures application of the internal control regime by undertaking a final check on the application of the internal controls in performing the point of control on all expenditures. However, Treasury performing this final point of control is a source of inefficiency, with Budget Organisations having to travel to a Treasury Regional Office in order to have their expenditure processed. This is of particular concern for municipalities in rural, often isolated, areas.

Treasury has commenced a process of decentralising the final point of expenditure control to Budget Organisations. This decentralisation will be contingent on a risk-based assessment of the application of internal controls with each budget organisation.

Score B

(iii) Degree of compliance with rules for processing and recording transactions

Compliance with financial regulation is very high and there is no exceptions in these regulations in regards to specific cases. All issues in registering of financial transactions are given in Financial Rule Number 2 for spending of public finances. Budget Organizations are not allowed to sign contracts before having the commitment entered in the system. This is explained in the Treasury Administrative Directive for beginning of each financial year. Nonetheless, internal audit reports indicate that, in a minority of cases, the rules have not been properly applied. As an example, there have been cases when a contract is signed before the commitment of funds was entered in the system, and there remains an issue when the financial rules not being followed for the recording of invoices in KFMIS when they are received (See PI-4)

Score B

PI-20	Explanation	(Score M1)
(i) Effectiveness of expenditure commitment controls	**Score B** (i). Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception.	
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures	**Score B** (ii). Other internal control rules and procedures incorporates a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g. through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays.	**B**
(iii) Degree of compliance with rules for processing and recording transactions	**Score B** Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification.	

3.4.9 PI-21 Effectiveness of Internal Audit

(i) Coverage and quality of the internal audit function

UNMIK Regulation number 1999/16 established in the second half of 2000 the Internal Financial Audit Unit (IAU) within the Central Fiscal Authority (CFA, which later became the MFE), and this operated until 2002 with the establishment of Provisional Institutions of Self-Government of Kosovo (PISG). Audit reports were submitted to the management of the BO in which the audit was performed and to the CFA Head.

In May 2003, the Law on Public Financial Management and Accountability was passed, and Article 8 established the Internal Audit Unit in MEF, which subsequently became the central Department of Internal Audit in MEF with the responsibility for internal audit capacity building and conducting audits in the PISG. The DIA performs centralized audit functions similar to external audit, focusing on managing the system of internal control. A number of auditors in DIA and MEF have had the responsibility to perform broad audits within the Government. On November 16, 2006, the Assembly approved the Internal Audit Law and it was approved by SRSG on 6th June 2007 on internal audit. It established a Central Harmonization Unit (CHU) for settling internal audit standards, for training internal auditors and reviewing their performance (IAL, Article 6).

Currently, out of 60 BOs (Ministries, Municipalities, Agencies), 50 have established IAUs staffed by 84 Internal Auditors including three pilot municipalities. However, 33 BOs function with only one auditor, which is permitted by the law. This is considered insufficient for the efficient functioning of internal audit in terms of capability, and sufficient capacities for planning, managing, and effective IA.

Number of auditors through IAUs

Nr. of IAUs	Nr. of auditors in IAUs	Total
1	9	9
2	4	8
6	3	18
8	2	16
33	1	33
50		84

Out of 50 budgetary organizations that have established IAUs, over 88 percent (44) of them have prepared strategic plans for 2009-2011. An annual report for 2009 was produced by 86 per cent. Based on these plans there is a shortfall of some 63 internal auditors if a more efficient functioning IA is to be achieved. This additional number would ensure that IAUs should be composed of two and more auditors.

Audit Committees (AC) have been established at the end of 2008 in 24 BOs to ensure the independence and protection of IAU auditors and to undertake measures for implementation of recommendations given to senior management by the IAU. The CHUIA has undertaken all necessary steps to establish and make operational IA Committees based on a template statute representing best practice.

An IA Manual has been produced by CHU in close cooperation with experts of the EC-funded project "Further Support for Internal Control of Public Finances and Internal Auditing" to have further harmonization with International Standards and Professional Practices of Internal Audit. It consists of three volumes:

- The first volume presents the role and functioning of internal audit, responsibilities and principles, and policies for its guiding module statute of IAU; model strategic and annual plan; internal audit standards, code of ethics; best professional practices, etc.
- The second volume details activities of audit teams when conducting specific audit (from planning to implementation of recommendations).

- The third volume presents means and techniques that should be used by auditors in performing each audit.

The Manual was published on the MEF website in January 2009.

MEF is continuously engaged in professional capacity building of the internal audit function and has been supported by three projects:

1. Further Development of Administration in Central Level and Strengthening of Internal Audit and Internal Financial Controlling Systems in Kosovo from January 2004 until March 2006. This project has helped MEF to develop a decentralized system of internal audit and has build capacities of internal auditors of BOs.
2. Technical Assistance for supporting the MEF Department of Internal Audit from February until July 2006. It has assisted the MEF Department of Internal Audit to implement effectively its annual audit plan towards continuing professional education of internal audit staff.
3. Further Support for Internal Control of Public Finances and Internal Audit from March 2007 until 31st of August 2008. This project involved 100 auditors and with the international experts completed 25 pilot audits in compliance with international standards and professional practices of Internal Audit and the European Union. In addition, the project has helped in developing primary and secondary legislation.

However, even though internal auditors have attended different training courses on internal audit provided by different international companies, these did not provide the certification as required by IAL. Since there is no internationally recognised professional association that provides certifying of internal auditors in Kosovo, the CHU is continuously engaged and has requested donors to support a project for certifying internal auditors. The EU is supporting this to enable the certification of Internal Auditors who afterwards will be licensed by the CHU and it is planned to start in second quarter of 2009.

While the development of the internal audit function is relative new with respect to a modern approach, internal audits are performed in all BOs. In 2008, IAUs have compiled strategic and annual plans for 2009, which were approved by senior management. Audits are performed based on international standards and professional practices of IA, referring to IAL, and the IA manual, which is in accordance with International standards and professional practices of internal audit (ISPPIA/SNPPAB) and the Code of Ethics of Institute of Internal Auditors. Internal Audits are performed systematically and comprehensively based on systems, compliance, performance and financial aspects Audits based on systems are referred to the Internal Control system assessment process in order to evaluate if there are internal controls and if they are functioning effectively. Financial audits include examination and reporting on financial statements.

Score B

(ii) Frequency and distribution of reports

Internal Audit Reports compiled by the auditor are submitted regularly to senior management in line with the Law. The IAU compiles quarterly and annual reports on BOs` internal audit activities, which are received by the CHU. The CHU compiles annual report on activities and functioning of IA and submits it to the Minister of MEF, who reviews the report, and together with comments submits the respective report to the Government, Assembly, and OAG. The CHU`s first report is in process of being finalized.

Score A

(iii) Extent of management response to internal audit findings

Senior Management comments on the draft report with the auditor in closed meetings before having it finalized and management commits itself to implement recommendations. The Chief Administrative Officer of a BO is the main person to undertake immediate measures for implementation of any given recommendations by IAU. Implementation of recommendations depends on weight, importance, and serious undertaking by the Senior Management of the BO.

The number of audits held so far is 292 and the number of recommendations made is 1,937, of which 1,039 (53.6%) have been implemented with a further 485 (24.8%) in the process of being implemented. With respect to the 422 (21.9%) recommendations that have yet to be implemented, some are in the process of being implemented, and others are planned to take place in 2009 in line with the Action Plans.

Score B

PI-21	Explanation	(Score- M1)
(i) Coverage and quality of the internal audit function	**Score B** (i). Internal audit is operational for the majority of central government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time))	B+
(ii) Frequency and distribution of reports	**Score A** (ii). Reports adhere to a fixed schedule and are distributed to the audited entity, ministry of finance and the SAI	
(iii) Extent of management response to internal audit findings	**Score B** (iii). Prompt and comprehensive action is taken by many (but not all) managers.	

3.5 Accounting, recording and reporting

3.5.1 PI-22 Timelines s and Regularity of Accounts Reconciliation

(i) Regularity of bank reconciliation

Collection, saving and spending of public money is done through a Single Treasury Account (STA), which is reconciled on a monthly basis. The STA consists of a “main account, and for the sake of easier revenue identification and reconciliation, Treasury established sub-accounts for each budget organizations that collect public revenues within the STA. Sub-accounts are classified as follows:

a) Sub-accounts for the revenues collected from budget organizations
b) Sub-account for trusted money and
c) Sub-accounts for expenditures (salaries, pensions).

Payments from taxpayers are made in all licensed commercial banks in Kosovo with the destination in CBK sub-account opened for BOs.

All public expenditure is made from the "main account" of the STA and this account is reconciled daily.

All sub-accounts are reconciled at least monthly, by the end of each calendar month. The Treasury Department submits all sub-accounts reports electronically daily to the revenue collecting Budget Organizations (central and local level). These bank reports[16] regarding the state of accounts enable BOs to enter their revenues collected into KFMIS classified by revenue type, economic code and respective department. The Revenue Division in Treasury monitors revenue recording and participates in the monthly reconciliation. In addition to the daily and monthly reconciliation of bank accounts, the Reporting and Accounting Division requires all BOs to go to the Treasury offices on a quarterly basis to reconcile recorded revenues and expenditures in KFMIS. Each BO confirms that the records of respective budget line for all revenues and expenses comply with KFMIS, and both of these should reconcile with the CBK bank account. The reconciliation process will not be signed between BOs and the Treasury if any of the reconciliation does not match, even if it is a minor amount. The reconciliation process is thus performed in a very transparent and timely manner as required by LPFMA so that no material differences are left unexplained.

Score A

(ii) Reconciliation regularity, clearance of suspense accounts and of advance payments

In the past, following a request from the World Bank, Treasury opened suspense accounts on two or three occasions to accommodate the situation when WB projects were close to completion, in order to have expenses reflected in the project for Auditing and Payment.

Currently, Treasury does not maintain any suspense account for the management of public money. All the payments and outflows from the Kosovo Consolidated Budget are made from the Single Treasury Account. As mentioned in the PI-17, the report on all STA transactions is received on daily basis from the Treasury in both electronic and hardcopy formats. All transactions of this account are reconciled in the Central Treasury against the KFMIS generated data's on daily basis.

However, although not numerous, there are some problems in relation to daily STA reconciliation. In some instances, there is a lack of data to identify certain amounts such as the return of salaries, social payments, pensions etc.

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[16] Treasury approved an Administrative Instruction for the implementation of UNIREF – which enables accurate and timely revenue identification

In order to have more efficient petty cash management, the Central Treasury handed over to five Treasury regions its petty cash management. NLB is the selected bank for petty cash maintenance, which can be authorized from the regional officials for petty cash needs and for official trips. Replenishment of these advances is preceded by reconciliation process for the expense made from the previous advance payment. Prior to the end of the fiscal year, this advance payment should be returned (transferred) in CBK from NLB.

Treasury no longer uses suspense accounts. Clearance of advances is performed twice a week. Replenishment of these advances is preceded by reconciliation process for the expenses made in the previous advance payment.

Score B

PI-22	Explanation	Score- M2)
(i) Regularity of bank reconciliation	**Score A** Bank reconciliations for all central government bank accounts take place at least monthly at aggregate and detailed level, usually within 4 weeks of the end of period.	**B+**
(ii) Reconciliation regularity, clearance of suspense accounts and of advance payments	**Score B** Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period. Some accounts have un-cleared balances brought forward.	

3.5.2 PI-23 Availability of Information on Resources Received by Service Delivery Units

Primary health care and primary and secondary education are the responsibility of municipality governments. Consequently, municipalities are responsible for service delivery, financing, budgeting, and reporting. Service delivery in these two sectors is primarily financed by municipalities from specific operating grants transferred from the central government. In addition, certain activities – such as major capital investment and pharmaceutics distribution – are conducted by responsible line ministries within specifically designed programmes within their budgets.

In principle, resource allocation to the lowest level spending units – schools and health clinics - is indicated only at the aggregate sector level in municipal and ministry budgets respectively. Some municipalities have developed internal working documentation showing budget distribution to spending units; however, this information is not normally part of their official budget submission nor is it systematically provided to spending units or published. Further, some purchases are conducted through central administration "in bulk" and distributed to units. Reporting on such transfers are not regularly compiled or published.

The Treasury Chart of Accounts and procedures are designed in a way that allows budget execution to be recorded and monitored at the lowest spending level. However, due to some elements of expenditure budgeted in bulk; this information represents only a partial and incomplete picture. Information on in kind transfers – such as drugs – is missing. Reports are not compiled and published.

In future, it is important that both budget planning and recording processes be advanced to utilize fully the facilities created by the Treasury system. The World Bank has a pilot project to start budgeting by individual schools in three municipalities. There should also be a Public Expenditure Tracking Survey implemented in Kosovo.

Score D

PI-23	Explanation	(Score-M1)
Availability of information on resources received by service delivery units	**Score D** (i). No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.	**D**

3.5.3 PI-24 Quality and Timeliness of in- year Budget Reports

(i) Quality and timeliness of in-year budget reports

The Government of Kosovo has a system for public financial management and it can generate monthly, quarterly, and annual reports.

All reports are presented in compliance with IPSAS and requirements of the Law on Public Financial Management and Accountability. Reports are by structure of the budget and present fund balance commitment on a monthly and quarterly basis for each economic category and Budget Organization. These reports are based on the KFMIS data which is reconciled with the SAT accounts on a monthly basis (daily for the "main account"). The fiscal reports are reliable and present all financial data.

Score A

(ii) Timeliness of the issue of reports

As required by the LPFMA, the MFE is obliged to prepare quarterly financial reports and to submit them to the Government and the Assembly of Kosovo. These reports should be submitted on time and not later than 30 days from the end of a quarter and the deadline has always been met. In addition to the reports preparation, for the purposes of MEF management information, Treasury also prepares weekly and monthly reports on receipts and payments, comparison of budget implementation and comparison of same period of time in previous years, as well as and other necessary issues such as for capital projects, etc.

Score A

(iii) Quality of Information

The information contained in the in-year reports is of a good quality. In-year reports use KFMIS data that has been reconciled with the STA accounts and, for quarterly reports, a process of reconciling the reports of individual Budget Organisations with the consolidated reports.

Prior external audit reports of the KCB have raised concerns regarding the classification of expenditures. Classification of payments to individuals has been an issue of concern. However, this has improved significantly due to harmonisation in the definition of the economic categories of expenditure used for budget execution verses budget planning. Budget circulars have highlighted these issues and it is now considered that such errors do not compromise the usefulness of the reports.

Score B

PI-24	Explanation	(Score-M1)
(i)Quality and timeliness of in-year budget reports	**Score A** (i). Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages.	**B+**
(ii) Timeliness of the issue of reports	**Score A** (ii). Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period.	
(iii) Information's quality	**Score B** (iii). There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/usefulness.	

3.5.4 PI-25 Quality and Timeliness of Annual Financial Statements

(i) Completeness of the financial statements

Consolidated financial statements are prepared by the Treasury in accordance with the LPFMA (03/L-048) requirements, respectively section 46, which sets the time of annual report submission and its content.

Consolidated financial statements contain information sufficient for receivables, payments, assets, financial liabilities, comparison with earlier years, outstanding obligations, capital assets, situation of government loans, number of employees, etc.

Financial statements of Budget Organisations are prepared using the Kosovo Financial Management Information Systems (KFMIS) data, while these statements should demonstrate accountability and transparency. The report includes statement of cash receipts and payments, a consolidated statement of cash assets and fund balances, statements of funds with Central Banking Authority of Kosovo, funds with commercial banks, privatisation fund, cash in transit, cash in hand (cash box) and designated donor fund. It also includes a statement of non-financial assets and an outstanding invoices report by Budget Organisations.

Score A

(ii) Timeliness of submission of the financial statements

In accordance with LPFMA section 46, the MFE is required to prepare and submit to the Government and Assembly the final budget report, including the Annual Financial Statements for the previous fiscal year, no later than March 31.

The final budget report is prepared by Treasury, and for all the PEFA years, the legal date for submission was respected and statements were submitted no later than March 31 from the closure of the fiscal year. This is supported also by evaluations from the Office of Auditor General.

In accordance with LPFMA, section 44, Budget Organizations are required to submit to the Director of Treasury a non-audited financial statement and written confirmation for veracity and accuracy of their financial transactions for the previous year, 30 days after the closure of fiscal year. Mainly, BOs submit timely financial statements, excluding municipalities with a Serbian majority.

Score A

(iii) Accounting standards used

The financial statements of 2007 have been prepared in accordance with the LPFMA and Cash Basis IPSAS *Financial Reporting under the Cash Basis of Accounting.* It states the notes to the financial statements form an integral part in understanding the statements and be read in conjunction with the statements. The statements indicate that these accounting policies have been applied consistently throughout the period.

Score A

PI-25	Explanation	(Score-M1)
(i) Completeness of the financial statements	**Score A** (i). A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities.	
(ii) Timeliness of submission of the financial statements	**Score A** (ii). The statement is submitted for external audit within 6 months of the end of the fiscal year.	**A**
(ii) Accounting standards used	**Score A** (iii). IPSAS or corresponding national standards are applied for all statements.	

3.6 External scrutiny and audit

3.6.1 PI-26 Scope and Nature of Follow-up of External Audit

(i) Scope/nature of audit performed (incl. adherence to auditing standards)

The Office of the Auditor General (OAG) was established by UNMIK Regulation nr. 2002/18, which defined authorizations, responsibilities, and general standards for auditing the public sector. Under a new law nr. 03/L-075 of 15th June 2008, the OAG received more power and reports to Kosovo Assembly. The OAG is now responsible for auditing of government performance funded through the consolidated budget (central and local governments), as well as public enterprises.

Audits are based on audit planning compiled by OAG itself. This planning is based on the capacities of the OAG`s audit staff supported by a small team of International Audit experts who have provided support under EU project assistance. OAG has a staff of 60 auditors assigned to 5 audit departments, based on the distribution of public entities that will be audited by each Audit Department. Since its establishment, all OAG staff have attended continuous audit trainings providing knowledge on international audit standards. These standards drive the phases of the audit planning process conducting analytical tests, fieldwork standards and audit report formulation.

Due to this, the OAG has prepared and finalized Audit Report of KCB Financial Statements for 2007, relying only on its own local audit staff capacities.

OAG audit activities on KCB for 2006 were focused on items of policy and budgetary significance of 19 major Budget Organizations. These Budget Organizations represented 60% of expenditures and 89% of revenues. For each Budget Organization, a specific audit report is published on the OAG website, in which detailed findings are presented.

For 2007, KCB financial statements were prepared on a consolidated basis as all revenues and expenditures for Ministries, Municipalities and other Budget Organisations were transacted through the Single Treasury Account. Audit activities of OAG for KCB for 2007 covered 21 budgetary organizations, which represented 71% of expenditures and approximately 86% of revenues, which combined to give 80% coverage. A specific audit report for each BO is published on the website in which detailed findings are presented.

Score B

(ii) Timeliness of submission of audit reports to legislature

The Audit Report of the Office of the Auditor General on Financial Statements of the Kosovo Consolidated Budget for the Year ended 31 December 2007 was published in November 2008. The Audit Report is addressed to the Minister of Ministry of Economy and Finance and Assembly of Kosovo. These financial statements were signed by the Minister of MFE and the Head of Treasury on 31 March 2008. The 2008 Financial statements were signed on 25 March 2009.

Score B

(iii) Evidence of follow up on audit recommendations

A formal response by the MFE is included in the OAG report with a follow up comment by the OAG. This is also the case for individual BO audit reports.

There is some evidence of follow up. The OAG reports that in 2006, the KCB underwent some changes (which it listed) which derived from the implementation of previous audit recommendations. However, it also extracted 7 key points that derived from the audit of the KCB of 2006 and 2007, where the financial statements of 2006 and 2007 continued to be not compliant with requirements of Accounting Internal Standards in the Public Sector of Financial Reports according to the cash basis of accounting. Nevertheless, it concluded that in the general context, during 2007 in relation to previous years, there has been improvement in financial management, bookkeeping, and timely presentation of statements. Nevertheless, the OAG made some 971 recommendations in 31 BOs in 2006 and 2007, and 606 were still waiting implementation by the end of 2008.

The OAG states in the report that the Assembly (through the Committee for Budget and Finance) consults OAG on budget proposals, and audit and review reports, but considers that the Assembly's interest is more on budget than audit reports. The OAG concludes from this observation that the Assembly rarely gives recommendations to the executive branch on OAG's findings.

Score B

PI-26	Explanation	(Score- M1)
(i) Scope/nature of audit performed (incl. adherence to auditing standards)	**Score B** (i). Central government entities representing at least 75% of total expenditures are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues.	
(ii) Timeliness of submission of audit reports to legislature	**Score B** (ii). Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.	**B**
(iii) Evidence of follow up on audit recommendations	**Score B** (iii). A formal response is made in a timely manner, but there is little evidence of systematic follow up.	

3.6.2 PI-27 Legislative Scrutiny of the Annual Budget Law

(i) Scope of Assembly's Scrutiny

The annual budget calendar in Kosovo is well established, both in practice and in law (the original 2003 Law on Public Financial Management and Accountability as well as the 2008 version), and the Government's roles and the Assembly's roles are provided in the law. The LPFMA requires that the Government's draft budget be submitted to the Assembly by 31 October to ensure adequate time for review prior to the start of the coming fiscal year.

The LPFMA gives the Assembly direct authority to determine the budget of "independent" agencies, such as the regulatory agencies, in order to minimize the potential for undue political influence in the operation of these agencies.

In practice, the Assembly delegates its review of the draft budget to the Budget Committee who in recent years has been given up to 4 weeks to review the document.

In reviewing the 2009 Budget, the Assembly received analytical and strategy documents, including the MTEF macro-fiscal and sector strategies, as input to their decision making. However, the Budget and Finance Committee as well as the Assembly itself are limited in the depth and scope of their scrutiny of the strategic elements because both entities lack professional staff trained in analytical activities. As a result, the Committee generally focuses its attention on revenue and expenditure information in the Annual Budget Law.

The Assembly is currently receiving support from donors in the development of a database of trained professionals who can be available to provide analytical skills, and the database will be ready in time for the 2010 budget review cycle.

Score C

(ii) Extent to which the Assembly's procedures are well-established and respected

Procedures for the deliberations on the budget by the Budget and Finance Committee are well established, and they include engaging other Assembly Committees, the MFE and Government, as well as specific Budget Organizations in conducting hearings for the debate of the proposed budget. However, other Assembly Committees are not involved widely or routinely in budget reviews. Some of the practices of the Committee in reviewing the budget, including some of the hearings held with Budget Organizations, have proven to be inefficient, and moved the focus away from higher-level strategic issues.

Score B

(iii) Adequacy of time for the Assembly to provide a response to budget proposals, both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)

According to the LPFMA, the budget shall be submitted to the Assembly at least 2 months before the start of the new fiscal year, that is, prior to October 31. The 2008 budget was submitted to the Assembly on November 11, 2007 and the 2009 budget was submitted on November 3, 2008.

Score B

(iv) Rules for in-year amendments to the budget without ex-ante approval by the Assembly

Clear rules exist for in-year budget amendments by the Government, and are usually respected. Nonetheless, in both 2007 and 2008 budget cycles, extensive reallocations occurred (outside of the planned reallocations as provided for by the Mid-Year Review process), which has harmed the concept of budget discipline in the Budget Organizations and the Assembly.

None of the provisions in the Law enables the total level of appropriations to be expanded.

Within and between the Municipal and Central Budget Departments of the MFE there was uncertainty and inconsistency as to the application of some provision of the law, such as the application of limits to transfers between capital projects and between Budget Organizations.

The revision to the LPFMA and the Law on Budget for 2009 both sought to regulate this issue more closely and a much clearer set of rules now exists.

Score B

PI-27	Explanation	(Score-M1)
(i) Scope of Assembly's scrutiny	**Score C** (i) The legislature's review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized.	C+
(ii) Extent to which the Assembly's procedures are well-established and respected	**Score B** (ii) Simple procedures exist for the legislature's budget review and are respected.	
(iii) Adequacy of time for the Assembly to provide a response to budget proposals, both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)	**Score B** (iii) The legislature has at least two months to review the budget proposals	
(iv) Rules for in-year amendments to the budget without ex-ante approval by the Assembly	**Score B** (iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations	

3.6.3 PI-28 Legislative Scrutiny of External Audit Reports

(i) Timeliness of examination of audit reports by the Assembly (for reports received within the last 3 years)

Unlike its review of the budget proposals, the Assembly and the Budget and Finance Committee review the Auditor General's reports within 2 months of receiving them, but these reports are not scrutinized very closely and so their content cannot cover the full range of issues that are presented in the reports. The Auditor General's technical capacity to conduct audits continues to grow, but the capacity of various Assembly committees to examine and utilize reports on an in-depth basis is not yet as strong as it should be. At the same time, the Assembly and the committee continue to lack a professional staff (trained in auditing and related areas) which can provide a detailed review and assessment of the Auditor General's reports.

Score A

(ii) Extent of hearings on key findings undertaken by the Assembly

In-depth hearings on key findings take place occasionally, and cover only a few audited entities. While the external audit process continues to develop in Kosovo, the Assembly's overall process for receiving reports, reviewing their findings, making recommendations, and overseeing the results of those recommendations, remains weak.

Score C

(iii) Issuance of recommendations by the Assembly and implementation by the Government

Actions are recommended from reports regarding critical issues, which are of the most interest to the Committee, but they are rarely acted upon by the Budget Organization and there is little or no follow-up information about monitoring by the Government or Assembly.

Score C

PI-28	Explanation	(Score-M1)
(i) Timeliness of examination of audit reports by the Assembly (for reports received within the last 3 years)	**Score A** (i) Scrutiny of audit reports is usually completed by the Assembly within 2 months from receipt of the reports.	
(ii) Extent of hearings on key findings undertaken by the Assembly	**Score C** (ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only.	**C+**
(iii) Issuance of recommendations by the Assembly and implementation by the Government	**Score C** (iii) Actions are recommended, but are rarely acted upon by the Government	

3.7 Donor practices

3.7.1 D-1 Predictability of Direct Budget Support

(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).

In the early stages of United Nations administration from 2000 to 2004, approximately €180 million in direct budget support was received from donors to assist in funding the budget. The direct budget support in the year 2000 comprised more than 50% of the total revenue received, reflecting the need for substantial reconstruction spending during a time when revenue collection capacity was in its infancy.

Due to a series of large fiscal surpluses up until the end of 2003, Kosovo built up cash reserves totalling more than €300 million. During this time, and subsequently, revenue raising capacity has improved significantly. From 2004 onwards, the budget has grown without the need to take on debt, while bank balances in excess of €180 million have been retained at the end of each year. During the years 2004 through to 2007, only €1 million in donor budget support was received (in 2006) and therefore there was only limited requirement for coordination of such funding.

The 2008-2010 MTEF included a "financing gap", for which the Government explicitly sought receive direct budget support from donors.

At the Donor Conference held in mid-2008, donors pledged significant direct budget support to Kosovo, reflecting the funding gap presented in the Government's updated Medium Term Expenditure Framework. The Ministry of Finance and Economy understands that €208.4 million in direct budget support was pledged at the 2008 Donor Conference, with €69.3 million euro to be received in 2008. However, no budget support was actually received by Kosovo from donors in 2008.

The possible reasons for the delay in direct budget support include:

1. the strong fiscal balances during most of 2008, where bank balances only declined significantly in the last two months of 2008;
2. the desire of the major donors to develop a policy matrix and other measures for tracking progress in implementation of key policies; and
3. timing of initiatives, such as the development of a PFM Reform, designed to reduce fiduciary risk and improve PFM generally, prior to donor funding of the budget.

Due to the fact that the pledges made at the 2008 Donor's Conference were made part-way through the year, and not within 6-weeks prior to the 2008 Budget being submitted to the Assembly, it has been determined that it is technically not appropriate to score this indicator.

Score: Not Applicable

(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

Donors made commitments at the 2008 donor's conference to provide budget support in 2008 and 2009. However, no donor has as yet provided a forecast of budget support disbursements quarter by quarter (either individually or jointly) for either 2008 or 2009. As such, the requirements for a score of C or better are not met and D is the resulting score.

However, it must be recognised that the Government did not request of donors quarterly disbursement plans. This reflects that Kosovo is going through a process of restructuring its donor coordination functions and during the period following the Donor's Conference, there was insufficient human resources available in the donor coordination unit to undertake a complex level of coordination with donors. A plan exists to increase resources and enhance the level of coordination with donors regarding disbursement estimates of donor budget support. Nonetheless, these issues of capacity and process do not change the technical approach to scoring this indicator, which requires a score of D.

Score D

D – 1	Explanation	(Score- M1)
(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature	**Score D** **Donors didn't provide the budget support committed at the 2008 donors conference**	D
(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	**Score D** (ii) The requirements for score C (or higher) are not met.	

3.7.2 D-2 Financial Information Provided by Donors for Budgeting and Reporting on Project and Programme aid

(i**) Completeness and timeliness of budget estimates by donors for project support.**

A Donor Coordination Unit (in various forms, titles and locations within the Government) has operated in Kosovo for several years, initially in the Ministry of Finance and Economy, and then in the Office of the Prime Minister, and currently within the Office of European Integration.

A Donor's Conference was held for Kosovo during mid-2008 prior to the finalisation of the 2009 Budget. The Donor Coordination Unit received information on donor commitments following the Conference that included information showing support by sector and a separate presentation of amounts pledged by donor. While this information was useful in identifying total support, it was not useful for budgeting purposes in that it did not show the donor support split by project, did not identify which donor was supporting which sector, did not split the sector estimates by Budget Organisation, and did not include a breakdown using the Government's budget classifications.

The exception to this was the European Union's IPA funding, where the EU did provide to Budget Organizations estimates of future IPA support and the requirement for budget co-financing and this did form an element in planning the 2009 Budget. While IPA is a substantial program of support, it represents less than half of total donor budget support provided to Kosovo.

In summary, In summary, the majority of donors (and certainly not all of the 5 largest) provided complete estimates for disbursement of project aid. As such the requirements for a score of C or better are not met.

Score D

(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.

The Donor Coordination Unit has typically sought and received historical information from donors regarding their actual yearly expenditures. These estimates were recorded in a centralized database known as "RIMS". However, the donor reports on actual expenditures have consistently been received from donors and recorded in RIMS more than 2 months after the end of each fiscal year. As evidence of this , as at March 2009, the most recent data in the RIMS database is for 2007.

Score D

D – 2	Explanation	(Score- M1)
(i) Completeness and timeliness of budget estimates by donors for project support.	**Score D** (i). Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start.	**D**
(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.	**Score D** (ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget. This information does not necessarily provide a break-down consistent with the government budget classification	

3.7.3 D-3 Proportion of aid that is managed by use of National Procedures

(i) Overall proportion of aid funds to central government that are managed through national procedures.

Donor funds received by the Treasury in Kosovo are classified as "Designated Donor Grants". The following table identifies the total level of donor assistance reported by donors and recorded in the RIMS database managed by the Donor Coordination Unit as well as the amount of donor funds received in the Treasury according to the KFMIS (and Treasury financial statements). The table shows that the level of donor funds received directly in the Treasury and spent under the authority of the Law on Public Financial Management and Accountability is comparatively very small – generally less than 10% of total donor assistance. Furthermore, many of the grant agreements that govern the designated donor grants that are received specify that the procedures to be used in expending such funds are different from the standard government procedures, including the areas of procurement and audit.
Score D

Year	Total Donor Development Assistance (RIMS) €m			Designated Donor Grants (Treasury) €m	
	Committed	Contracted	Spent	Received	Percentage of Total Assistance
2000	1062	877	607	39.2	6.5%
2001	615	774	593	38.1	6.4%
2002	344	321	399	17.0	4.3%
2003	215	188	277	29.0	10.5%
2004	201	156	169	9.5	5.6%
2005	239	163	138	11.2	8.1%
2006	201	188	167	18.5	11.1%
2007	177	153	129	11.5	8.9%

D-3	Explanation	(Score- M1)
(i) Overall proportion of aid funds to central government that are managed through national procedures..	**Score D** Less than 50% of aid funds to central government are managed through national procedures.	**D**

4. On the reform agenda

After nine years as an UN-administered territory, Kosovo declared independence in February 2008. In recent years, Kosovo has made progress toward establishing functioning institutions of government, but still faces enormous challenges. The current government institutions of Kosovo began life as the Provisional Institutions of Self-Government (PISG) since 2002 and progressively assumed key functions transferred from UNMIK following the adoption of the UN Standards for Kosovo in late 2003. Despite visible success in a number of institutions, many of Kosovo's governmental organizations are still inexperienced and under-resourced.

Various diagnostics have pointed out that with limited revenue sources and increasing demand for public spending on human and infrastructure development, efficiency and transparency of public financial management is key to the economic stabilization and development in Kosovo. While the fiscal balance and sustainability has been re-established in 2005, achieving strategic resource allocation and efficiency and accountability of public spending needs to overcome many challenges, many of which are related to institutions and capacity building primarily in the line ministries.

Responding to this high priority of public financial management reform, the Government has taken several reform initiatives, supported by a number of international development partners, including DFID, EAR, USAID, and the World Bank. The previously completed PEFA assessment has shown that the Kosovo authorities have made noticeable progress in improving the public financial management system in recent years. In particular, the computerized treasury system is capable of producing detailed spending reports using internationally compatible classifications in a timely manner. However, weaknesses remain. Public procurement, payroll management, and internal and external control do not reliably perform their functions in ensuring efficiency and fiduciary control. Also, low capacity for executing pubic investment has caused continuous under-spending in recent years.

It is recognized by the Kosovo authorities that there exists a need to prepare the Government-led PFM action plan based on the recent diagnostics, including PEFA Assessment, Capital Expenditure Review, and the on-going public procurement study. The support for Government-led PFM action plan is reflected in the backing for the PEFA – the Ministry of Economy and Finance, the Prime Minister's Office; Ministry of Local Government, Ministry of Public Services, Public Procurement Agency, as well as others). In addition, international financial institutions and bilateral donors are now discussing providing a joint budget support to Kosovo Consolidated Budget. This will require Kosovo authorities to prove a satisfactory level of fiduciary accountability through making strong efforts to address weaknesses identified in the previous and current diagnoses.

The results of the PEFA assessment will be used to define the boundaries and priorities of the PFM reforms that will be included in the Government's PFM reform action plan, which is currently under development. These reforms are intended to accelerate the building of the public sector's capacities in practical and sustainable ways, and their implementation should focus on line ministries and municipalities in order to achieve maximum financial and programmatic results on behalf of the people of Kosovo. The Performance Measurement Framework identifies the critical dimensions of performance of an open and orderly PFM system as follows:

1. *Credibility of the budget* - The budget is realistic and is implemented as intended

2. *Comprehensiveness and transparency* - The budget and the fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public.

3. *Policy-based budgeting* - The budget is prepared with due regard to government policy.

4. *Predictability and control in budget execution* - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.

5. *Accounting, recording and reporting* – Adequate records and information are produced, maintained, and disseminated to meet decision-making control, management and reporting purposes.

6. *External scrutiny and audit* - Arrangements for scrutiny of public finances and follow up by executive are operating

As well as the PFM initiatives, the Government has also undertaken a "Whole of Government" review, which focuses on Functional Review and Institutional Design of Ministries. This work is complementary to PFM reform as it looks at how the delivery of Government services should be managed.

Annex 1: Summary and Explanation of Indicator Scores

	Score	Explanation
PI-1 Aggregate expenditure out-turn compared to original approved budget	C	The degree of deviation from the actual budget and planned budget: was 16.7% in 2008; 10.8% in 2007 and 10.2% in 2006. This under-spending is also to be seen in the context of significant increases in expenditures of 44% in 2008 from 2007 reflecting a tendency to over budget.
PI-2. Composition of expenditure out-turn compared to original approved budget	A	The variances in excess of the total deviation have not exceeded 5% (2008: 4.9%, 2007, 0.7%, and 2006: 2.1%) which reflects that the under-spending has been distributed relatively evenly between Budget Organization.
PI-3. Aggregate revenue out-turn compared to original approved budget.	A	Actual domestic revenue collection was in excess of forecasts in each year from 2006 to 2008 ranging from 5.4% to 33.4% reflecting growth GDP and associated imports.
PI-4. Stock and monitoring of expenditure payment arrears.	B+	The share of arrears as a percentage of total expenditure is negligible (less than 0.2. Debts are recorded by age, but there are some issues with respect to reconciliation.
PI-5. Classification of the budget	A	The Budget Classification/Chart of Account is based upon Government Financial Statistics (GFS) 2001 and is COFOG compliant. While it is possible to produce consistent documentation according to these standards for the economic, administrative, and functional classification, these are only routinely produced electronically for budget execution. The functional classification for budget formulation can only be produced manually at present as the coding for administration within a ministry is the same as administration as a function.
PI-6. Comprehensiveness of information included in budget documentation.	B	Budget documentation meets 6 out of the 9 elements for good budget information.
PI-7. Extent of unreported government operations	A	There is no extra budgetary expenditure as funds are included in the budget and recorded through the Single Treasury Account. All donor funding received by the Government from donors in cash is channelled through the Treasury. There are no bank accounts operated outside of the STA by Project Implementation Units or Budget Organizations for the implementation of donor-funded projects.

PI-8. Transparency of Inter-Governmental Fiscal Relations	B	The Law on Local Government Finances (LLGF) introduced transparent rules and secured funding for the delivery of minimum standard services by local governments. The aggregate amount of transfers and its allocation to individual municipalities complied with rules and procedures established in the LLGF. Grants parameters were determined and approved by the Grants Commission, and officially communicated to all municipalities through Budget Circulars. Nevertheless, information on final grant financing, which differed from preliminary estimates in terms of amounts and structure, was provided to municipalities almost one month after statutory deadline for municipal budget process completion. Determination of final transfers and allocation principles was disturbed by ad hoc last-minute policy decisions, which the weakened objectivity and transparency of grants allocation. Municipal budget formulation, execution, and reporting are handled within a single Financial Information Management System and fiscal information is consolidated into regular reporting performed by the Treasury Department, including quarterly budget execution reports and annual financial statements.
PI-9. Oversight of aggregate fiscal risk from other public sector entities	C+	There are two categories of Public Enterprises: Socially Owned Enterprises (SOEs) which are under the Kosovo Privatization Agency (KPA) and Publicly Owned Enterprises (POEs) which report to the POE Policy and Monitoring Unit in the Ministry of Finance and Economy. These POEs are individually audited by independent auditors and any issues are summarized in the OAG's annual audit report on the KCB. While the SOEs report on a quarterly basis and while those SOEs under direct administration by KPA are audited, a consolidated report of all SOEs is not produced and there is no report on overall fiscal risk. The legal framework in place does not allow local governments to enter into any debt obligations, thus generate fiscal liabilities for the central government.
PI-10. Public Access to key fiscal information	B	In 2008, public access to information for four of the six categories was through statutory reports and use of web sites.

PI-11. Orderliness and participation in the annual budget process	B	A defined budget calendar is established at the start of the budget process and is communicated to BOs. Three budget circulars at central level and two in municipal level were issued for the 2009 budget, but external events delayed them, which in turn reduced the time available for the budget preparation relative to the defined calendar. Expenditure ceilings are communicated via the circulars. However, the expenditure aggregates contained in the MTEF were changed two weeks after its publication and the Cabinet did not deliberate and approve the ceilings prior to the second circular being issued. The 2007 budget was approved before the start of fiscal year, whereas the 2008 budget was approved 2 months late due the request from the new government for review. The 2009 budget was approved before the start of fiscal year.
PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	C	The MTEF is based on a 3 year (not as yet) rolling forecast of the resource envelop which determines the fiscal framework for the annual budget. However, the MTEF is not reconciled with the annual budget for the overlapping year. The MTEF document presents a mission statement and description of the existing situations, and goals for the sectors, but these are not uniform in quality or clarity. The bottom-up element of the MTEF is being developed with work being undertaken on sector strategies Kosovo has a Public Investment Programme (PIP) under which investment projects are assessed as to potential viability. However, the recurrent cost implications are not factored into subsequent budgets and the lack of a coherent sector strategy means that projects are developed in isolation. The PIP is not integrated into the MTEF and is in effect a centrally driven list of projects.
PI-13 Transparency of Taxpayer Obligations and Liabilities	B	Tax legislation is available from the two tax departments' websites and regular taxpayer education is carried out. However, taxpayer confidence in the tax administration is low because of inconsistent and low quality interpretation of the law with staff within the TAK not meeting the requirements of the legislation or good tax administration practice. Appeals mechanisms exist and are implemented

		though some concern about objectivity has been raised.
PI-14 Effectiveness of measures for taxpayer registration and tax assessment	D+	Both Tax Administration and Customs are dependent on the MTI (Agency for Business Registering) database. Integrity of business registration continues to be a serious issue because of lack of effective verification procedures in MTI. While penalties for non-compliance are considered sufficient, their effectiveness is compromised due to low enforcement by the courts and the ability to circumvent them by closing and opening a new business particularly by importers. Risk assessment software has recently been introduced for Tax Administration, but the audit function needs to be reorganised to become more effective. Customs operates risk assessment criteria in its software and uses this for selection of both physical inspections and post-import audits.
PI-15 Effectiveness in collection of tax payments	D+	Arrears in 2007 amounted to at least 4.4% of tax collected. Total arrears are increasing rather than decreasing so new arrears are greater than arrears collected. Revenues are paid into the treasury bank account within 48 hours and reconciliation is timely.
PI-16. Predictability in the availability of funds for commitment of expenditures	A	The Division of Cash Flow and Debts Management monitors revenues and expenditures, forecasts cash flow stock, manages debt and preserves budget liquidity. DCF&DM manages allocations through the year to ensure that budget is executed within the available cash amount. Allocations by Goods and Services, Subsidies and Transfers are made on a quarterly basis. Wages and Salaries allocations are made monthly to maintain control on the number of employees in relation to the approved budget. Allocation of Capital Expenditures funds is done on a quarterly basis based on expenditures plan submitted by the BO. BOs are able to commit expenditure for at least 6 and possibly up to 12 months) in advance within appropriation limits. Cash flow plans are controlled by the staff responsible for cash flow management, whereas BOs make adjustments of cash plans after each budget change (amendment), as well as based on the reasonable request that BOs can make especially after good planning of commitments and

		expenditures for capital projects. There is a mid-term review of budget implementation after which a supplementary budget can be passed by the Assembly. Transfers (virements) are allowed by the Law and is subject to established rules.
PI-17 Recording and management of cash balances, debt and guarantees.	A	Within DCF&DM a debt unit has been established; and during 2008 a law on debt was drafted to be passed by Government to the Assembly for approval. In December 2008, software for debt management was purchased, whereas implementation of software and training of staff for use of software will be done in the first half of year 2009. The Government has created a Single Treasury Account, which is used to manage all transactions of the Government and these are consolidated on a daily basis. The Minister of Finance and Economy has the role of a Government agent and is authorized to represent the Government in borrowing and guarantee activities.
PI-18. Effectiveness of payroll controls	D+	Kosovo currently has a payroll system but no integrated personnel database, but as BOs update the payroll monthly, prior to the execution of the payroll, the changes are made in a timely basis and retroactive adjustments to the payroll are rare. However, in 2008 the payroll software was upgraded. One of the features of the new software is the ability to record the audit trail of the changes, which ensures that any change to a particular record is recorded and can be traced back to its originator. An ongoing issue is the lack of budgetary control in the processing of the payroll Thus while internal controls exists for changes to the payroll, these do not ensure that budget allocations or staff limits are not exceeded. At the end of 2006, the Payments division initiated a clean-up of the database. One of the aims was to ensure that every person has an ID card number within the database. It also runs checks on a monthly basis to ensure that people older than 65 are not paid. The Auditor General's office conducts yearly audits of the payroll system. The last audit was conducted in 2007.

PI-19 Competition, value of money and controls in procurement.	B	While the proportion of open competition procedure is 81%, there are concerns that public tendering does not sufficiently reach the market. The application of less competitive procedures is considered to be used only in specific cases and it is showing a decreasing trend. The Institution of Procurement Review Body is an independent institution that has been established to raise transparency and equality in public procurement, which is one of the conditions of Association-Stabilization Agreement between Kosovo and EU.
PI-20. Effectiveness of internal controls for non-salary expenditure	B	The public finances internal control function is defined in the LPFMA and elaborated in the PFIC policy document. There are two central harmonization units: one for internal audit and the other one for Public Finances Internal Control. At the beginning of each quarter, every BO analyzes all its potential liabilities, as well as procurement plans in order to ensure that it has committed funds. The process for controlling public finances is comprehensive and meaningful. Control is exercised through various assigned responsibilities throughout different phases within BOs themselves, with a final control provided by the Central Treasury. The process for controlling public finances is comprehensive and meaningful.
PI-21. Effectiveness of Internal Audit	B+	Currently, out of 60 BOs, 50 have established IAUs staffed by 84 Internal Auditors but 33 function with only one auditor, which is considered insufficient for the efficient functioning of internal audit. Nevertheless, audits are performed based on international standards and professional practices of IA. Internal Audit reports are submitted regularly to senior management and the IAU compiles quarterly and annual reports on BOs internal audit activities, which are received by the CHU, which compiles an annual report and submits it to the Minister of MEF, who reviews the report and together with comments, submits the respective report to the Government, Assembly and OAG. The number of audits held so far has been 292 and the number of recommendations made is 1,937, of which 53.4% have been implemented with a further 24.8% in the process of being implemented. With respect to the 21.9% recommendations that have

		yet to be implemented, some are in the process of being implemented and others are planned to take place in 2009 in line with the Action Plans.
PI-22 Timeliness and regularity of accounts reconciliation	B+	The Treasury Department submits all account reports electronically on a daily basis to the revenue collecting BOs (at central and local level). These bank account reports allow BOs to record daily collected revenues into KFMIS. The Reporting and Accounting Division, based on the LPMFA, requires on quarterly basis all BOs to come to the Treasury offices and to reconcile recorded revenues and expenditures in KFMIS. Each BO confirms if the records of respective budget lines for all revenues and expenses comply with KFMIS; while both of these should be reconciled with the CBK bank account. The reconciliation process will not be signed-off between BOs and Reconciliation Division if any of the reconciliation levels do not match, even if it is minor amount. The Treasury does not maintain any suspense account. All the payments and outflows from Kosovo Consolidated Budget are made from the Single Treasury Account
PI-23. Availability of information on resources received by service delivery units	D	In principle, resource allocation to lowest level spending units – schools and health clinics - is indicated only at the aggregate sector level in municipal and ministry budgets respectively. Treasury CoAs and procedures are designed in a way that allows budget execution recorded and monitored at the lowest spending level. However, due to some elements of expenditure budgeted in bulk this information represents only partial and incomplete picture. Information on in-kind transfers, such as drugs, is missing. Reports are not compiled and published.
PI-24. Quality and Timeliness of in-year budget execution reports	B +	All reports are presented in compliance with IPSAS. Reports are by structure of the budget and present fund balance commitment on a monthly and quarterly basis for each economic category and BO. The fiscal reports are reliable and present all financial data. These reports are submitted on time.
PI-25. Quality and timeliness of annual financial statements.	A	A financial report on the Kosovo Consolidated Budget is produced for the year ending 31 December covering (i) all BOs and (ii) the Kosovo Trust Agency. The report includes statement of

		cash receipts and payments, a consolidated statement of cash assets and fund balances, statements of funds with Central Banking Authority of Kosovo, funds with commercial banks, privatisation fund, cash in transit, cash in hand (cash box) and designated donor fund. It also includes a statement of non-financial assets and an outstanding invoices report by budget organisations. The Minister of MFE prepares and submits to the Government, for approval and submission to the Assembly, a final budget reconciliation report on the budget for the previous fiscal year and the two prior two fiscal years. The report for 2007 was signed and submitted on 31 March 2008. The financial statements of 2007 have been prepared in accordance with the LPFMA and Cash Basis IPSAS *Financial Reporting Under the Cash Basis of Accounting*. The statements indicate that these accounting policies have been applied consistently throughout the period.
PI-26. Scope, nature and follow-up of external audit.	B	OAG has a staff of 60 auditors assigned to 5 audit departments. Since its establishment, all OAG staff have attended continuous audit training providing knowledge on international audit standards. Audit activities of OAG for KCB for year 2007 were focused in 21 budgetary organizations, which representing 71% of expenditures and approximately 86% of revenues. A specific audit report for each BO is published on the website in which the detailed findings are presented. The Audit Report on the Financial Statements of the KCB for the year ended 31 December 2007 was published in November 2008 and is addressed to the Minister of MFE and the Assembly of Kosovo. These financial statements were signed by the Minister of MFE and Head of Treasury on 31 March 2008. A formal response by the MFE is included in the OAG report with a follow up comment by the OAG. This is also the case for individual BO audit reports. There is some evidence of follow up. OAG reports that in 2006, KCB underwent through some changes, which derived from the implementation of previous audit recommendations. The OAG made some 971 recommendations in 31 BOs in 2006 and 2007

		while at the end of 2008, 606 are still waiting implementation.
PI-27. Legislative scrutiny of the annual budget law.	C+	The LPFMA gives the Assembly direct authority to determine the budget of "independent" agencies, such as the regulatory agencies, in order to minimize the potential for undue political influence in the operation of these agencies. In practice, the Assembly delegates its review of the draft budget to the Budget Committee, which lacks professional staff trained in analytical activities. As such, the Committee generally focuses its attention on revenue and expenditure information in the Annual Budget Law. Procedures for the deliberations on the budget by the Budget and Finance Committee are well established, and they include engaging other Assembly Committees, the MFE and Government, as well as specific BOs in conducting hearings for the debate of the proposed budget. Clear rules exist for in-year budget amendments are usually respected. Nonetheless, in both 2007 and 2008 budget cycles, extensive reallocations occurred (outside of the planned reallocations as provided for by the Mid-Year Review process), which has harmed the concept of budget discipline in the BOs and the Assembly.
PI-28. Legislative scrutiny of external audit report	C+	The Assembly and the Budget and Finance Committee review the Auditor General's reports within 2 months of receiving them, but these reports are not scrutinized very closely or on all topics, as the capacity of various Assembly committees to examine and utilize reports on an in-depth basis is as strong as it should be. At the same time, the Assembly and the committee continue to lack professional staff. In-depth hearings on key findings take place occasionally, and cover only a few audited entities. Actions are recommended from reports regarding critical issues, which are of the most interest to the Committee, but they are rarely acted upon by the BO and there is little or no follow-up information about monitoring by the Government or Assembly.
D-1 Predictability of Direct Budget Support	D	At the Donor Conference held in mid-2008, donors pledged significant direct budget support to Kosovo, reflecting the funding gap presented in the Government's MTEF. The MFE understands that

		€208.4 million in direct budget support was pledged at the 2008 Donor Conference, with €69.3 million to be received in 2008. However, no budget support was actually received by Kosovo from donors in 2008. There is no evidence of the Government agreeing with donors on any in-year disbursement estimates of donor budget support pledged during 2008.
D-2 Financial information provided by donors for budgeting and reporting on project and programme aid	D	During 2008, the Donor Coordination Unit requested and received from donors estimates of future disbursements, which was used in preparation for the donor conference but was not used in the preparation of the MTEF nor the 2009 budget with the exception of European Union IPA funding, whose requirement for budget co-financing did form an element in budget planning. Estimates of donor funding are not currently included in budget documents. The Donor Coordination Unit has typically sought and received historical information from donors regarding their actual yearly expenditures. These estimates were recorded in a centralized database known as "RIMS". As at March 2009, the most recent data in RIMS is for 2007.
D-3 Proportion of aid that is managed by use of national procedures	D	The level of donor funds received directly in the Treasury is generally less than 10% of total donor assistance. Many of the grant agreements that govern the designated donor grants that are received specify that the procedures to be used in expending such funds are different to the standard government procedures, including procurement and audit.

Annex 2: Deviation Tables

2008 Kosova General Budget (€ millions)					
Organisations/Institutions	2007 Original Budget	Actual Expenditure	Difference	Absolute Deviation - Actual expenditures & annual budget appropriations	%
Total Municipalities	150.3	157.6	7.2	7.2	4.8%
Ministry of Economy and Finance	171.3	82.5	(88.8)	88.8	51.8%
Ministry of Labour and Social Welfare	157.7	146.4	(11.3)	11.3	7.2%
Ministry of Transporation and Telecommunication	111.4	126.9	15.5	15.5	13.9%
Kosovo Trust Agency	97.0	48.3	(48.7)	48.7	50.2%
Kosovo Police Service	60.1	57.9	(2.2)	2.2	3.7%
Ministry of Health	57.9	60.4	2.5	2.5	4.3%
Ministry of Education, Science and Technology	56.2	52.4	(3.8)	3.8	6.8%
Ministry of Public Services	24.3	16.7	(7.7)	7.7	31.7%
Office of KPC Coordinator	19.0	18.0	(0.9)	0.9	4.7%
Ministry of Justice	17.4	14.5	(3.0)	3.0	17.2%
Ministry of Environment and Spatial Planning	12.2	4.7	(7.5)	7.5	61.5%
Ministry of Internal Affairs	11.7	11.1	(0.6)	0.6	5.1%
Kosovo Judicial Institute	11.1	9.1	(2.0)	2.0	18.0%
Customs	11.0	8.8	(2.2)	2.2	20.0%
Ministry of Culture, Youth and Sports	9.4	10.5	1.1	1.1	11.7%
Ministry for Communities and Returns	9.1	6.3	(2.8)	2.8	30.8%
Ministry of Agriculture, Forestry and Rural Develo	8.7	8.6	(0.1)	0.1	1.1%
Ministry of Trade and Industry	5.7	4.0	(1.8)	1.8	31.6%
Ministry of Local Government Administration	5.1	5.4	0.3	0.3	5.9%
Other	46.1	33.0	(13.1)	13.1	28.4%
Central Own Source Revenues	25.7	15.8	(9.9)	9.9	38.5%
Total Expenditure	**1,078.6**	**898.8**	**(179.8)**	**179.8**	**16.7%**
Deviation Components	**1,078.6**	**898.8**		**232.8**	**21.6%**

Comment

1. Central Budget consists 902,498,529 €
2. Municipal Budget consists 187,833,818 - 37,500,000 = 150,333,818 (own-source revenues are not included nor in planning neither in execution)

2007 Kosovo General Budget (€ millions)					
Organisations/Institutions	**2007 Original Budget**	**Actual Expenditure**	**Difference**	**Absolute Deviation - Actual expenditures & annual budget appropriations**	**%**
Total Municipalities	136.3	134.0	(2.3)	2.3	1.7%
Ministry of Labour and Social Welfare	129.2	121.6	(7.7)	7.7	6.0%
Kosovo Trust Agency	75.9	78.2	2.3	2.3	3.0%
Kosovo Police Service	56.6	51.9	(4.7)	4.7	8.3%
Ministry of Health	52.2	48.8	(3.4)	3.4	6.5%
Ministry of Transportation and Telecommunications	35.6	22.6	(12.9)	12.9	36.2%
Ministry of Education, Science and Technology	33.9	27.8	(6.0)	6.0	17.7%
Office of KPC Coordinator	18.8	17.7	(1.2)	1.2	6.4%
Ministry of Justice	15.4	13.8	(1.6)	1.6	10.4%
Ministry of Finance and Economy	14.1	10.6	(3.6)	3.6	25.5%
Ministry of Justice	12.9	7.5	(5.3)	5.3	41.1%
Ministry of Environment and Spatial Planning	9.6	5.8	(3.8)	3.8	39.6%
Kosovo Judicial Council	9.1	8.9	(0.2)	0.2	2.2%
Customs	8.6	7.7	(0.9)	0.9	10.5%
Assembly	8.3	6.0	(2.3)	2.3	27.7%
Ministry of Culture, Youth and Sports	7.3	6.8	(0.5)	0.5	6.8%
Central Election Commission	6.7	4.8	(1.8)	1.8	26.9%
Ministry of Agriculture, Forestry and Rural Developr	6.4	5.8	(0.6)	0.6	9.4%
Ministry of Communities and Returns	6.2	6.1	(0.2)	0.2	3.2%
Ministry of Internal Affairs	5.4	5.6	0.2	0.2	3.7%
Other	40.9	24.1	(16.8)	16.8	41.1%
Central Government OSR	11.0	8.7	(2.3)	2.3	20.9%
Total Expenditure	**700.5**	**624.8**	**(75.7)**	**75.7**	**10.8%**
Deviation Components	**700.5**	**624.8**		**80.8**	**11.5%**

Comment:

1. Central budget consists 553,138,94€
2. Municipal budget consists 164,335,000 – 28,000,000 = 136,335,000€(own-source revenues are not included)

2006 Kosovo General Budget (€ millions)					
Organisations/Institutions	**2007 Original Budget**	**Actual Expenditure**	**Difference**	**Absolute Deviation - Actual expenditures & annual budget appropriations**	**%**
Total Municipalities	132.5	139.5	6.9	6.9	5.2%
Ministry of Labour and Social Welfare	127.7	126.3	(1.4)	1.4	1.1%
Kosovo Trust Agency	67.7	56.0	(11.7)	11.7	17.3%
Kosovo Police Service	56.8	49.9	(7.0)	7.0	12.3%
Ministry of Health	48.5	48.0	(0.5)	0.5	1.0%
Ministry of Transporation and Telecommunications	28.9	26.5	(2.4)	2.4	8.3%
Ministry of Education, Science and Technology	27.1	20.3	(6.8)	6.8	25.1%
Ministry of Finance and Economy	23.7	10.8	(12.9)	12.9	54.4%
Office of KPC Coordinator	18.1	18.0	0.0	0.0	0.0%
Justice	16.2	13.3	(2.9)	2.9	17.9%
Ministry of Environment and Spatial Planning	14.5	10.0	(4.5)	4.5	31.0%
Prison Services	11.3	9.6	(1.7)	1.7	15.0%
Ministry of Public Services	9.5	7.1	(2.4)	2.4	25.3%
Ministry for Communities and Returns	9.5	9.2	(0.3)	0.3	3.2%
Customs	8.6	8.3	(0.3)	0.3	3.5%
Assembly	7.5	5.6	(1.9)	1.9	25.3%
Ministry of Culture, Youth, Sports and NRI	6.4	6.4	0.0	0.0	0.0%
Central Election Commission	3.9	0.4	(3.5)	3.5	89.7%
Office for Community Issues	3.7	3.2	(0.5)	0.5	13.5%
Kosovo Police Service School	2.8	2.1	(0.7)	0.7	25.0%
Other	41.1	29.9	(11.2)	11.2	27.3%
Central Government OSR	11.9	8.6	(3.4)	3.4	28.6%
Total Expenditure	**677.9**	**608.7**	**(69.2)**	**69.2**	**10.2%**
Deviation Components	**677.9**	**608.7**		**83.0**	**12.2%**

Comment:

1. Central budget consists 533,453,011 €
2. Municipal budget consists 166,546,990 - 34,000,000 = 132,546,990 (own-source revenues are not included neither in planning nor in realizing)

Annex 3: People interviewed

<u>**Ministry of Public Services**</u>
Ms. Shpresa Dushi

<u>**Kosovo Tax Administration**</u>
Mr. Ekrem Hysenaj
KTA Deputy Director

<u>**Customs**</u>
Miss. Valdete Krasniqi
Budget and Finance Director
Mr. Agim Nika

<u>**Public Procurement Agency (PPA)**</u>
Mr. Ilir Rama
PPA Executive Director
Mr. Safet Hoxha
Mr. Sami Uka
Mr. Afrim Bajrami

<u>**Office of Auditor General**</u>
Mr. Muje Gashi

<u>**Ministry of Labour and Social Welfare**</u>
Ms. Valbona Muja
Ms. Luljeta Salihu

<u>**Independent Public Procurement Commission**</u>
Mr. Ilaz Dula
Director of IPPC
Mr. Basri Dedinca

<u>**Ministry of Local Government**</u>
Ms. Vjollca Selimi

Procurement Review Body

Mr. Ruzhdi Kurtishaj

Mr. Hysni Hoxha

Assembly of Kosovo

Mr. Gani Koci

Head of Budget and Finance Commission

POE Policy and Monitoring Unit

Mr. Kadrush Thaqi

Kosovo Privatization Agency

Mr. Avni Jashari

Mr. Skender Hasani

Agency for Coordination for Development and European Integration

Ms. Elvana Bajraktari

Senior Officer for Coordination of Development and European Affairs

Treasury Regional Office –Peja

Ms. Senavere Novoberda

Manager of the Office

Municipality of Peja

Ms. Aferdita Grapci

Budget and Finance Director

Annex 4: Documents Consulted

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