Public Finance Management Reform Strategy (PFMRS) of Kosovo 2016-2020

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Abbreviations

- PAR - Public Administration Reform
- PFM - Public Finance Management
- EC - European Commission
- SGPAR - Special Group on PAR
- SBS - Sector Budget Support
- IPA - Instrument for Pre-Accession Assistance
- EU - European Union
- PEFA - Public Expenditure and Financial Accountability
- OECD - The Organisation for Economic Co-operation and Development
- SIGMA - Support for Improvement in Governance and Management
- TADAT - Tax Administration Diagnostic Assessment Tool
- OAG - Officer of Auditor General
- RP - Responsible Team
- MTEF - Medium Term Expenditure Framework
- IT - Information Technology
- IMF - International Monetary Fund
- PFMRS - PFM Reform Strategy
- PIFC - Public Internal Financial Control
- TAK - Tax Administration of Kosovo
- SBA - Stand By Agreement
- LPFMA - Law on Public Financial Management and Accountability
- GDP - Gross Domestic Product
- MoF - Ministry of Finance
- PPRC - Public Procurement Regulatory Commission
- SPO - Strategic Planning Office
- OPM - Office of Prime Minister
- MEI - Ministry of European Integration
- CSO - Civil Society Organization
- USAID - United State Agency for International Development
- WB - World Bank
- GIZ - Deutsche Gesellschaft für die Internationale Zussamenarbeit
- PIMA Report - Public Investment Management Assessment
- BO - Budget Organisation
- POE - Publicly Owned Enterprise
- PMU - POE Monitoring and Policy Unit
- KFMIS - Kosovo Financial Management Information System
Executive Summary

Within reforms foreseen in Public Administration Reform (PAR), Kosovo aims at ensuring a modern system of Public Finance Management (PFM), which is in harmony with best international practices. This will enable efficient and effective functioning of all stages of Public Finance Management. As part of joint dialogue between the Government of Kosovo and European Commission (EC), in the meeting of Special Group on PAR (SGPAR), financial support has been ensured through Sectorial Budget Support (SBS) from the European Union (EU) Instrument of Pre Accession (IPA) funds. Currently, an agreement for sectorial budget support for two first pillars of the PAR is expected to be signed within IPA 2016. While the finalization of the second budgetary sectorial support in relation to the PFM sector within IPA 2017 is expected. Both agreements are conditioned with the request that Kosovo approves a strategy for better quality in the area of Public Finance Management, which would in correct manner address findings of evaluation reports in this area such as PEFA, SIGMA, TADAT but also those of OAG.

Initially, based on decision no. 105/2015, a Responsible Team (RT) for drafting Strategy was established in September 2015 and it is composed of representatives of all relevant actors of governmental institutions of Kosovo. The team, with the support and expertise provided by OECD/SIGMA, has initially analysed relevant evaluation documents of the PFM area such as PEFA, SIGMA, TADAT and the OAG Report 2015. The four pillars and twelve priorities of the strategy were agreed on based on the findings.

I. Fiscal discipline
- Accuracy of macroeconomic indicators and revenue forecasting
- Effective commitment controls
- Sustainable revenue collection

II. Allocation efficiency
- Development of the Medium term expenditure framework (MTEF)
- Credibility and execution control of the annual budget
- Quality of information on capital investments

III. Operational efficiency
- Public Procurement
- Strengthening internal audit
- Strengthening external audit

IV. Cross-cutting PFM issues
- Enhancement of IT systems
- Transparency of budget
- Sustainable capacity development in the PFM

It is worth mentioning that the Strategy involves priorities that address challenges that were identified in abovementioned evaluations with the commitment to continue maintaining and updating the areas, which have already been regulated by international standards, in line with current developments. Public Finance Management Reform Strategy is drafted at the time when the Kosovo Government is implementing the 22-month Stand-By program with IMF, which aims at implementation of policies to achieve three main goals:

a) Promote fiscal consolidation and re-establish banking balances (budget reserve) of the Government within the program period;
b) Further strengthening of financial stability; and
c) Increase competitiveness and productive capacities.
Moreover, with the purpose of minimizing the risk of doubling the work, the strategy incorporates existing strategy in the area of PFM and envisaged annual updating and reviewing of Action Plan will also ensure incorporation of activities of future strategies in this area. The strategy contains the comments of all local stakeholders received during public consultation process and workshops organized to this end, but also of our other international development partners. Continued support starts from evaluations conducted in the area of PFM and continues during the phase of strategy drafting. We are convinced that this cooperation will be a guarantee to achieving building of the Kosovar PFM System, based on best international standards and practices, even during the phase of strategy implementation.

Chapter 1 Background to the PFM reform strategy

1.1 Aim of the strategy

The aim of the strategy is to achieve sound financial management by improving the systems that ensure (1) ‘fiscal disciple’, (2) ‘operational efficiency’ and (3) ‘effective allocation’ of Kosovo’s public resources. Given the importance of budgetary resources for public service delivery, improvement in the Public Finance Management system will affect all service areas and benefit the citizens making use of them.

This Public Finance Management Reform Strategy (PFMRS) sets down Kosovo's key reform plans in the management of the budget process including ‘strategic planning and budget preparation’, ‘budget execution’, ‘accounting and reporting’ and ‘audit and oversight’.

As the Public Finance Management system covers all processes relating to the preparation, execution and reporting on the budgetary resources, the PFMRS has an overarching perspective. In some of the PFM sub-systems, there are detailed strategies such as the strategy for public internal financial control (PIFC), and procurement strategy and the strategy to integrate TAK and Customs into a Revenue Administration have also been adopted. These sub-systems strategies continue to be applicable. Parts of these strategies are incorporated in this PFMRS given their crucial importance for the overall PFM system.

It should be noted that the PFMRS is focusing exclusively on the administrative and technical systems and does not address fiscal decisions on the allocation of the budgetary resources.

1.2 Relevance of the strategy for the partnership of Kosovo with the European Union

The PFMRS is closely related to Public Administration Reform (PAR) which is defined in the European Commission’s Enlargement Strategy as one of the pillars of the enlargement process, together with the rule of law and economic governance.

Adopting a PFM reform programme is also a prerequisite for sector budget support from the EU through the IPA. In the coming years, the Government of Kosovo plans to apply for the budget support mechanism in various sectors, including Public Administration and Public Finance Management. The EU will use the PFMRS as a benchmark for the commitment of Kosovo to ensure good governance and sound financial management.
1.3 The Programme with IMF

During 2015, Government has negotiated the 22-month Stand-By program (SBA). Given that Kosovo is not characterized with a fiscal or payment balance risk and that it does not have a monetary policy, this program is particularly focused in boosting sustainable economic development of the country. Considering the relationship that Kosovo has with the IMF as one of the main partners in drafting macro-fiscal policy, Kosovo has significantly defined the space in which it can accommodate new policies stemming from its strategic documents. In the framework of the program with IMF, considering the big structural obstacles that the economy is facing, Kosovo Government has changed the LPFMA to functionalize the investment clause in order to enable investment in infrastructural projects of development character, financed from international financial organisations.

In line with this, Government is committed to implement the structural reform program set in its strategic documents. Government has also presented payroll order based on the law, a mechanism that limits the salary increase in the public sector with nominal GDP growth in order to create a better link of public sector salary increase and productivity in economy. In order to increase efficiency in spending and transparency, in its reform agenda government has also foreseen application of centralized procurement as well as electronic procurement. To this end, during 20015 Government has adopted the list of six products that will be subject of centralized procurement for all budget organisations of the central level. Furthermore, during the midterm period Government aims to continue gradually to further expand the list of goods and services that will qualify for centralized procurement, and to cover all budget organisations, including municipalities and agencies. Concerning electronic procurement (e-procurement), government has drafted the legislation, which in the medium term makes the use of e-procurement mandatory for all budget organisations.

1.4 Method of preparation

Given that there are different actors in the area of Public Finance Management, the PFMRS has been prepared by the responsible team appointed by the MF. The team was led by the Department for European Integration and Policy Coordination, composed of main directorates of the Ministry of Finance including the Department of Budget, Central Harmonization Unit, Treasury Department, Department on Economic and Public Policies and International Financial Cooperation, Legal Department, Tax Administration of Kosovo (TAK), Kosovo Customs, IT Department, Department of Property Tax. Representatives of PPRC, OAG, SPO/OPM, MEI and MPA were also part of the team. Although the Office of the Auditor General (OAG) or Public Procurement Regulatory Commission (PPRC) are functionally independent from the Government, the OAG has agreed to contribute to the PFMRS as participant in the Working Group and as an institution that will commit to reforms included in the PFMRS.

The PFMRS has been consulted with the representatives of local and international civil society organizations (CSOs) active in Kosovo through regular public consultation process as well as with development partners as EU, USAID, IMF, WB, GIZ. In this context, during April 2016 were organized two consultative meetings, one with CSO representatives and the other with development partners. Apart from fruitful discussions, both parties have submitted written comments to the discussed draft Strategy and Action Plan. Following a review process by the responsible team, comments of development partners and CSOs are incorporated in the final version of these documents as much as it was possible. This has further improved the quality of the document. Action Plan will be
Anex.- 1 while the table attached in Annex.-2 of this document presents a summary of comments received from stakeholders and explanations why they were incorporated or not incorporated.

1.5 Structure of the document

The PFMRS is based on a thorough analysis of the existing weaknesses in the PFM systems of Kosovo as reported by international institutions and the Office of the Auditor General. Based on this analysis, in chapter 2 the PFMRS describes twelve priority objectives for the Government. These objectives have been gathered in four pillars of the PFM in order to identify necessary activities to achieve progress. Chapter 3 includes a more detailed analysis of 12 priority areas. The identified activities are further elaborated on in the Action Plan in Annex 1. This Action Plan includes specific measures/activities and presents specific indicators for years 2016-2020. Chapter 4 details the roles and responsibilities in the implementation of the PFRMS. And last but not least, Chapter 5 assesses the needs of administration in relation to necessary additional resources to conduct planned activities.

Chapter 2 Overall approach to PFM Reform

2.1 Situation analysis

In order to assess shortcomings in the PFM systems, the following four main documents were used during strategy drafting:

1. **Public Expenditure and Financial Accountability (PEFA):** PEFA is a methodology owned by various international development partners (including the World Bank and IMF) to measure the quality of public finance management. The last assessment for Kosovo was conducted on 31 January 2016 and covers the period until 2014 (2012-2014). The report provides comparison of findings of reports of PEFA 2007, 2009 and 2015;

2. **OECD/SIGMA Baseline Measurement:** On behalf of the European Commission, OECD/SIGMA carries out an annual assessment of the quality of the public administration in accession and neighbourhood countries including Kosovo. Part of the assessment focuses on Public Finance Management. The most recent measurement took place in 2015 and covers the period until the end of 2014;

3. **The IMF evaluation –TADAT:** This evaluation provided information on specific parts related to revenue collection. The report presents evaluation (grading) of performance of key components of the tax administration system of the country. The report provides a standard for performance evaluation of the system of Tax Administration which can be used to set reform priorities and with the later repetition of evaluations, emphasize achievements of the reform. The report was published in May 2015 and covers the period until 2014 (2011-2014). The evaluation in question identifies and measures critical results of TAK operations vis-à-vis best international practices; and

4. **The OAG’s Annual Report of the financial year 2014 published in 2015** provides the most recent audit results and recommendation of the Auditor General of Kosovo.
The analysis of strengths and weaknesses of the PFM system distinguishes the five main stages of budgetary cycle, which, for the purposes of analysis, are divided in sub-systems as follows:

I. Strategic planning and budget preparation;
II. Revenue collection;
III. Revenue collection, Treasury management and Expenditure controls;
IV. Accounting and reporting;
V. Audit and oversight.


2.1.1 Strategic planning and budget preparation

The following describes the strengths and weaknesses in different sub-systems of strategic planning and budget preparation.

- **Macro-economic planning / Revenue forecasting:** Both PEFA and SIGMA assessments of 2014 observe that macro-economic forecasts are generally too optimistic and revenues tend to be over-estimated.

- **Medium-term expenditure planning:** Both PEFA and SIGMA evaluation reports stress that the medium-term budgeting perspective has not been developed well yet and MTEF still fails to fully function as an instrument for resources allocation. Generally, the MTEF document focuses more on the annual budget projections whereas figures for the two following years in most of the cases are not so sustainable estimates. It is also noted that the current practice of MTEF preparation is that each BO submits its budget proposal for MTEF drafting. There is no sectorial approach for the MTEF stage (in which the BOs are consolidated in a single sector).

- **Fiscal risk:** PEFA refers to the potential fiscal risks by Public Enterprises and local government and observes that the GoK has made progress in strengthening its oversight over the financial situation of Publicly Owned Enterprises (POEs). Also, MTEF 2016-18 includes part of fiscal risks in relation to macroeconomic factors. Immediate strengthening of MTEF is needed in respect of its capability to carry out analytical analysis of fiscal risk. In its assessment, SIGMA observes that contingent liabilities are not disclosed in budget. The OAG’s audit report (for 2013) acknowledges that the Unit for Policies and Monitoring of POEs (UPMPOE) in the Ministry of Economy had improved its performance but notes that the Assembly has not played an active follow-up role to discuss audit findings with POE management. In the 2014 report, the OAG does not comment on fiscal risks from POEs.

- **Budget preparation procedures (calendar, ceiling, instructions):** PEFA Evaluation Report provides positive evaluation of regularity of annual budget preparation. Findings of SIGMA Report suggest there is room for improvement given that budget preparation has unnecessarily been complicated with numerous budgetary directives. Moreover, it notes limited use of MTEF ceiling for annual budget preparation (see also medium term expenditure planning).
- **Budget transparency (classification and coverage);** PEFA assess budget classification and coverage positively. PEFA notes that the upgrading of KFMIS has enabled the 2015 Budget to be the first budget to be shown according to functional/sub-functional classification as well and economic classification.

Also SIGMA states that the budget document includes all basic information and that the level of information may even be too detailed. However, it notes that some disclosures (such as the most recent estimates on current year) are lacking. Also, the budget does not yet include non-financial performance information.

All three reports, EFA, SIGMA and OAG find that payments of third parties by donors (including IPA funds) have not been adequately included (displayed).

- **Capital budgeting / Public Investment Planning (PIP);** PEFA notes the improvements in a number of processes related to PIP planning. However, the use of the system still falls well short of its full potential. This is mainly due to the lack of adequate regular training in the use of the PIP system.

SIGMA Report notes extremely high partaking of capital expenditures in total expenditures (27 %) and in few cases (or some cases) refers to unfair categorizing of recurrent expenditures as capital expenditures.

On the grounds of the material value of misclassification of recurrent expenditures as capital investments, the OAG has qualified the Annual Financial Statements of 2014.

The OAG also notes the inappropriate budget execution rate of capital projects at both central and local levels (80 %) which caused difficulties in meeting operational plans and objectives of BOs which also had an impact in reducing the investments in the private sector.

**2.1.2 Revenue collection**

The following are described the strengths and weaknesses in different sub-systems of revenue collection. In the beginning description in the area of Revenue Management has been provided:

- **Revenue administration;** PEFA notes that the introduction of fiscal numbers has improved tax administration, but notes that the appeals process through Court system is not functioning optimally.

Similarly, the Report of Diagnostic Evaluation of the TAK (TADAT), carried out by the IMF in May 2015, assesses that there is still poor management of unpaid taxes, combined with failure to pay back uncollectable debts, as well as poor monitoring of tax disputes and their conclusions.

- **Revenue collection;** At a general level, it is known that domestic revenue sources need to substitute for border revenues as ongoing integration in the European Union will reduce income from trade flows.

Revenue collection was 12% less than planned. This is partly caused by over optimistic forecasts overestimating foreign investment and government capital investments.

PEFA and OAG note that a main concern is the high level of uncollectable debts and that collection of tax arrears is low (20% of total).
2.1.3. Treasury Management and Expenditure Control

The following strengths and weaknesses have initially been divided in Treasure Management and Expenditure Control, The situation in Treasure Management is as follows:

- **Cash management;** PEFA and SIGMA observe that the main aspects of cash management including Treasury Single Account (TSA), cash forecasting and maintaining budget allocation limits function well. SIMGA Report mentions considerable pressure of end of the year expenditures. SIGMA Report also identifies absence of integrated communication of different IT systems.

- **Debt management;** PEFA and SIGMA observe that the Establishment of debt management unit has facilitated good debt management and that the basic conditions for ensuring borrowing from the market are in place. The level of debt/borrowing is low (below 11% of GDP). Although the Law on Public Debt enables municipalities to enter into borrowing arrangements, no municipality has done this yet. The OAG notes that the State Debt Programme prepared by the MoF has been in accordance with the macroeconomic and fiscal framework to ensure a sustainable debt position.

- **Payroll;** PEFA observes improvements by the relocation of the payroll system from Ministry of Public Administration to Treasury in 2014. This had the benefit of reducing errors in payroll processing, as BOs can supply monthly payroll data in electronic form directly to the payroll system in Treasury. At the time of the assessment, the HRMS was not yet linked to the payroll system, now located in Treasury but full electronic linkage is planned to be achieved during 2015. Until this integration happens, the BOs are using the payroll system and the HR management system separately. The OAG notes the significant changes in the expenditure structure during 2014. Expenditures for Wages and Salaries increased by 16% whilst expenditures for Capital Investments reduced by 22%. The OAG calls for reforms in the domain of public administration including the new salaries system and control and transparency in recruitment procedures.

Whereas in Expenditure Control we have come across the following findings:

- **Procurement;** PEFA notes that the 2011 Law on Public Procurement is close to best international practice and that procurement system in general is transparent regarding the information dealing with procurement which are available to public. It comments on the current practice as (i) the Public Procurement Regulatory Commission is being unable to determine whether use of non-competitive procurement procedures by BOs is justified as a procurement audit system not being in place; and (ii) the independent Procurement Review Body is not having any private sector representatives on its Board. Also SIGMA considers that the legal framework (compliant to the Acquis) is largely in place and that the institutional structure is functioning (with some capacity gaps). It also refers to a public procurement training strategy 2014-2018 that has been adopted to increase skills of procurement officers. Further room for improvement is identified in the lack of a national public procurement strategy, the effectiveness of the helpdesk service by PPRC, the motivation underlying the decisions of appeal mechanism and the lack of advanced procurement procedures (e.g. centralized procurement of framework contracts). SIGMA also notes that
procurement decisions are too often based on lowest price criterion without regard to quality of the bids which could result in problems in contract implementation.

- **Internal control**: Budget organizations generally operate in accordance with Treasury Rules and Procedures in relation to financial management. However, as noted by PEFA, despite efforts to strengthen compliance, incidences of non-compliance still occur (as reflected by OAG annual reports).

The three PEFA, SIGMA and the OAG reports note that the commitment controls have not been effective in limiting arrears. Such increased levels of payment arrears due to bypassing of commitment controls are burdening coming budgets.

Based on the OAG reports, PEFA also notes the room for improvement in other controls especially asset management. The OAG observes lack of assets registers and incorrect reporting of assets.

SIGMA observes that the legal framework is not fully harmonized with PIFC requirements. The roles and responsibilities do not ensure effective financial control and keep the focus of financial management on annual budget execution. Furthermore, a lack of institutional commitment is observed (as reflected by response rate on questionnaires).

Furthermore, concerning risks and weaknesses in the field of internal control, Government of Kosovo has now adopted the Strategy of Public Internal Financial Control which is being implemented. This strategy includes four main objectives that aim to address key challenges regarding internal control in the Government of Kosovo.

- **Budget reallocations during the year**: Both PEFA and SIGMA reports draw attention to the relatively large amount of budget reallocations during the year which is facilitated by the LPFMR which allows the transfer of up to 25% between budget lines without the need to inform the Assembly. Besides, special rules have been introduced for changing the budget in the Annual Budget Law that enable the Government to transfer up to 5% of the BOs budget without requesting prior approval of the Assembly.

### 2.1.4 Accounting and reporting

The following are descriptions of the strengths and weaknesses in different sub-systems of budget execution.

- **Accounting standards**: PEFA, SIGMA and the OAG confirm that all the requirements of IPSAS “Financial Reporting under the Cash Basis of Accounting” are being met.

- **Six-month financial reports**: PEFA signal no major weaknesses in the accounting systems and acknowledges the robustness of KFMIS and Treasury Single Account. As all budget organizations are connected to the KFMIS for the budgeting, accounting, and reporting function, accurate budget reports can be generated throughout the year.

SIGMA notes that in-year information to the Assembly is only provided on aggregate level.

- **Annual Financial Statement**: PEFA observes that in the last three years the MF has submitted the Annual Financial Statements within the required timeframe of 31st of March 2014. The OAG confirms The Consolidated AFS includes full info on revenues, expenditures, assets, liabilities and weaknesses are not material. The consolidation and reporting of assets has improved compared with previous year. However, as mentioned above (see capital budgeting),
expenditures of capital investment, goods and services and subsidies are not always classified in the adequate economic categories which has resulted in a qualification of the AFS 2014. SIGMA notes that government provides basic information but no data in compliance with ESA 2010 and non-financial information. Also the OAG notes the lack of performance information and recommends that more emphasis is required on achieving best value for money in the use of scarce resources.

2.1.5 Audit and oversight

The description of strengths and weaknesses in different sub-systems of audit and oversight is given belows

- **Internal audit**: PEFA concludes that, in general, internal audit (IA) in Kosovo is functional and meets professional standards. The main problem is addressing recommendations of internal auditing by the management of BOs.

  SIGMA notes that BA has been established in most BOs, whereas 49% of BOs have sufficient staff in the BA. In some BOs, the BA units are too small to act in compliance with standards, some BA reports are not always in compliance with standards. On the skills of internal auditors, SIGMA notes that 45% of auditors are certified and sustainability of training through Chartered Institute of Public Finance and Accountancy is not ensured.

  The OAG recognizes the problem of internal audit services in certain small independent institutions that are directly accountable to Assembly. These strengths and shortcomings are analyzed in details in the Strategy on Public Internal Financial Control and the action plan of this strategy foresees concrete measures to address these shortcomings.

- **External audit**: A new law to establish the OAG's mandate and independence in line with the ISSAIs is submitted to the Assembly;

  PEFA notes that concerning financial auditing the OAG has increased the mandate from 80% according to PEFA evaluation in 2009 to 100%. Both PEFA and SIGMA note that the bulk of audit capacity is devoted to regularity audit and that performance audit is still in the phase of development.

  The regularity audit manual that guides financial and compliance audit is in line with the international standards (ISSAIs) but SIGMA notes that the methodology is not always applied in practice to ensure high quality audits.

  A certification program was created based on ISSAI related to auditing of regularity and performance.

- **Parliamentary oversight in budget approval**: PEFA observes that in the last three years, in accordance with the LPMFA, the budget has been submitted to the Assembly at least 2 months before the start of the new fiscal year. The Rules of Procedure of the Assembly delegate the responsibility of the budget review to the Budget and Finance Committee (BFC). MTEF is submitted to the Assembly in April as provided by LPFMR for information but is not voted on. The LPFMA does not allow for the increase in the overall level of budget appropriations outside of the formal budget review process. The law provides for clear rules for in-year budget amendments which are well respected. But, excluding the category of goods and services, they allow transfer of one part of an allocation of budget organisation to another allocation of budget organisation of less than (25%) of the negatively impacted allocation without the need of written approval from the Assembly.
In addition, some special provisions on the rules on budget amendments have been introduced into the Annual Budget Law that allow the Government, in the last quarter when there are delays in realisation of planned spending, to transfer funds from BOs up to 5% of the total budget of the respective BO without requiring the prior approval of Parliament.

- *Parliamentary oversight in scrutiny of audit reports:* PEFA observes that during the last three years, the audit reports were reviewed by the Public Finance Oversight Committee (PFOC) of the Assembly of Kosovo within three months from their receipt. The Committee has begun to request the Budget Organizations to prepare and submit action plans to address the OAG findings. While PEFA notes that the work of the Committee with individual BOs has improved in the last couple of years, it has not placed any requirement on the Government to prepare action plans to address the recommendations of the OAG contained in its reports on the Annual Financial Statements of the Government. SIGMA notes that the Assembly has not issued recommendations on the Financial Management Control report.

### 2.2 Selection of reform priorities

The analysis of the PEFA, SIGMA and OAG reports demonstrates that the public finance management reflects a large number of strengths. However, the analysis also shows that there is room for improvement. Identified challenges have been ranked in four pillars (objectives) of public finance management:

I. Fiscal discipline
II. Allocation efficiency
III. Operational efficiency
IV. Cross-cutting PFM issues

Below is provided a short presentation of the current state of affairs and division of priorities according to pillars. Priorities are presented with actions to be taken in order to improve Public Finance Management of Kosovo.

#### 2.2.1 Pillar 1: Fiscal discipline

As a first objective, the PFM system should ensure that expenditures and revenues are balanced and that government does not incur unsustainable debts. In this context, the fiscal rule adopted in 2013 that limits the budget deficit to 2% of the GDP and keeps the level of debt under control ensures fiscal sustainability. Government remains committed to implement and further strengthen the fiscal rule, which will guide the fiscal policy in the next medium term period towards ensuring long term fiscal sustainability. At the same time the MoF is planning a number of measures that will create a sustainable framework of sustaining the overall fiscal discipline.

In general, our PFM system supports aggregate fiscal discipline. Revenue shortfalls are responded to by expenditure cutbacks. However, such expenditure cutbacks could be harmful for service delivery and could have prevented by more accurate revenue forecast. Therefore, realistic forecasting of macroeconomic indicators and revenues is put as priority 1.
To sustain fiscal discipline in the future years, finding domestic substitutes for border revenues will be essential to finance the public investment needed for sustained economic growth and to address Kosovo’s many challenges. Therefore, as priority 2 we put sustainable revenue collection.

If there is an increase in payment arrears, the overall fiscal discipline will be violated. Failure to pay in time will result in other budgetary cutbacks which might not be feasible in the economic and political aspect. As payment arrears mainly result because the commitment controls are not fully respected, we put effective commitment controls as priority 3.

2.2.2 Pillar 2: Allocation efficiency

As a second objective, the PFM system should support that the public funds are allocated in line with the priorities of government and should be supported by the political decision makers.

Given that it is not always possible to accomplish political priorities within a fiscal year, good instrument for decision makers is a medium term budget forecasting. The analysis shows that a medium term perspective to budgeting is still evolving. As priority 4, we put further development of the medium term expenditure framework (MTEF).

The medium term expenditure framework can only be effective if it is translated into the annual budget law. The process of budget drafting supports this to a certain extent. The budget preparation system appears to support this to some extent, though significant reallocations of budgetary funds between BOs during the year and allocations from significantly sized contingency funds implies that budget preparation could be improved in support of a more robust process of allocating resources according to strategic priorities. Credibility and execution control of the annual budget is set as priority 5.

Allocation in line with the priorities must be based on reliable information. The quality of the information is especially compromised in the case of capital budgets as reflected by the qualification of the Auditor General’s report. Also, the PIP system is not used to its full potential. The quality of information on capital budget is therefore proposed as priority 6.

2.2.3 Pillar 3: Operational efficiency

As a third objective, the PFM systems should support the delivery of public services by preventing the misuse of public funds and increasing the value for money for expenditures.

Concerning public expenditures about economic categories of expenditures for Wages and salaries as well as goods and services, Auditor General’s Report of 2013 shows that the pay list control poses no great risks any more, therefore it is not foreseen as priority in this strategy. Although the Law on Public Procurement is in accordance with best international practices, Kosovo is still faced with challenges in relation to effective implementation of this law. Accordingly, strengthening the procurement practice to enhance compliance with the applicable regulations is set as priority 7.

Compliance with the regulations is more likely to be achieved in a context that non-compliance is detected and corrected. Internal Control is the main priority under this pillar. Since for this area Government of Kosovo has adopted the Strategy on Public Internal Financial Control which addresses
main challenges of internal control, in the Public Finance Management Strategy priority is given to internal and external audit, as additional elements to other existing strategies. Effective internal and external audit are the appropriate mechanisms to detect non-compliance. Strengthening internal and external audits are proposed as priority 8 and priority 9.

2.2.4 Pillar 4: Cross-cutting PFM issues

In addition to the nine priorities identified above, three issues are identified that are crucial to support the achievement of all three PFM objectives. These are referred to as cross-cutting issues.

A first issue is the existence of different IT systems in managing the budget: KFMIS, payroll, E-procurement, E-assets, BDMS (Budget Development and Management System) and PIP System are currently in use. Each of these systems are functioning adequately. However, as inter-linkages are not fully established, the workload and the risk of errors are increased. As complete and correct information is crucial for informed decision-making, we put integration of IT systems as priority 10.

A second issue is transparency on budget. Although, the PEFA assesses budget transparency in Kosovo positively, there is room for improvement. Given that it is one of the eligibility criteria of the EC for sector budget support, we put increased transparency as priority 11.

A third issue is the capacity of civil servants working in the domain of public finance management. Legislation, regulations and reforms in the PFM may be implemented only with professional staff that fully understands regulations and implementable systems. So far training of the PFM staff has been fragmented and organized as part of specific projects. With the purpose of systematically enhancing capacities and skills of staff, sustainable training in the area of PFM is placed as priority number 12.

2.3 Overview of the reform priorities

Considering the above, twelve priorities have been identified for the KFMIS. They were selected and categorized in four pillars/objectives of the PFM, including a liaison pillar/objective. So priorities were listed according to Pillars/Objectives as follows:

<table>
<thead>
<tr>
<th>Pillar</th>
<th>Priority</th>
<th>Description</th>
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<tbody>
<tr>
<td>1 Fiscal discipline</td>
<td>1</td>
<td>Accuracy of macroeconomic indicator and revenue forecasting</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Effective commitment controls</td>
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<td></td>
<td>3</td>
<td>Sustainable revenue collection</td>
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<tr>
<td>2 Operational efficiency</td>
<td>4</td>
<td>Development of the Medium term expenditure framework (MTEF)</td>
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<td></td>
<td>5</td>
<td>Credibility and execution control of the annual budget</td>
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<td></td>
<td>6</td>
<td>Quality of information on capital budget</td>
</tr>
<tr>
<td>3 Operational efficiency</td>
<td>7</td>
<td>Public Procurement</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>Strengthening internal audit</td>
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<td></td>
<td>9</td>
<td>Strengthening external audit</td>
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</tbody>
</table>
4. Cross-cutting PFM issues

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<table>
<thead>
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<tbody>
<tr>
<td>10</td>
<td>Improving IT systems</td>
</tr>
<tr>
<td>11</td>
<td>Budget transparency</td>
</tr>
<tr>
<td>12</td>
<td>Sustainable capacity building in PFM</td>
</tr>
</tbody>
</table>

It is noted that the selection of priorities in the PFMRS is done in order to prioritize. It does not intend to give non-priority issues any importance. To the contrary, the issues assessed as advanced will constantly be followed up with the purpose of further improvement, but will not be part of the PFMRS. However, those improvements will not be monitored and steered via the PFMRS framework.

Chapter 3 Reform priorities

This chapter will provide further elaboration of priorities stemming from four pillars of the strategy. Starting from findings of relevant evaluation reports of SIGMA, PEFA, TADAT and ZAP, analysis of findings continues, which require taking of measures to overcome the situation towards improvement of the PFM system. Following is a summary of objectives of twelve Priorities based on description of identified problems, there is a presentation of analysis of causes of those problems and finally, considering all this, proposed activities aiming at achieving the objective of the Priority have been provided. Later, in the action plan, there is a more detailed elaboration of activities, time of implementation, bearers of activities and indicators to measure achievement of foreseen objectives. Below has been provided each Priority of the Strategy according to the structure described above.

Priority 1: Accuracy of macroeconomic indicators and revenue forecasting

**Objective of the reform.**- A careful and realistic forecast of main macroeconomic indicators and regular budget revenues and one-off revenues.

**Description of the problem.**- In recent years, budgetary framework was drafted based on overestimated revenues as well as planning of one-off revenue collection without being based on any highly sustainable criterion. Revenue overestimation has also occurred in own source revenue planning of municipalities. At the same time, the budget faces huge expenditures which were mainly related to pre-electoral promises and which resulted with huge burden for fiscal developments.

Year 2014, ended with under collection of 8.6% compared to initial planning, to which mostly contributed under collection of 17.2% in domestically collected revenues and 6.7% in revenues collected at the border. Irrespective of this, the 2015 budget was drafted based on a framework that failed to consider revenue collection during 2014. This budget was based on an increase of 7.8% of overall revenues compared to the 2014 budget, or 17.9% compared to their collection during 2014. Given that the Government has now adopted a fiscal rule which limits the deficit of budget in 2% of the GDP, this led to a situation where, in order to ensure observation of the rule, cutbacks in expenditure had to be carried out. Non-adjustment of expenditure level with current performance of budget revenues may lead to greater budget deficit than allowed by law, and consequently to an...
increase of state debt, partly in the form of unpaid obligations. As a result, and despite poor collection of revenues in 2014, accommodation of additional expenditures in budget caused a change in forecasting of budgetary revenues and inclusion of one-off revenues, the probability of collection of which was unknown.

Finally, in recent years, the budgetary framework was impinged by overly optimistic forecasting of budgetary revenues. This forecasting was incited by political pressures in order to cover ad-hoc policies that led to expenditure increase in general. In order to ensure respect for the rule, alternative measures are cuts in spending (which would negatively affect public services and the credibility of the budget) or ad hoc revenue raising measures (which may prove harmful in their macro-economic impact).

Among these additional measures that would contribute to preserving independence of macroeconomic and fiscal forecasting is proposed the creation of Independent Fiscal Council. The Independent Fiscal Council would assess drafting of the macroeconomic framework (and revenue forecasting) and in case the government does not respect their advice, it would provide the information through the media and would promote a public debate. Although the Fiscal Council in other countries may have positive impact in budgeting practice, it is considered that in Kosovo context such positive impact is not possible due to the small number of academic community with technical experience in the field of modelling and macroeconomic assessment as well as professional capacity of the media to present this debate. Therefore, more attention will be paid to preserving the existing structure and further increase of its capacities rather than to consider creation of new structures.

**Root causes.**- Different issues underlie the deviation of the revenue forecasts and actual revenues.

- Small number of employees in the unit for macroeconomic analyses. Currently, there are only three employees in the macroeconomic unit. Moreover, due to small offer of qualifications needed in this unit, there is a need to provide sustainable and comparable financial support to what is offered in the market in relation to such qualifications, in order to be able to attract quality staff possessing adequate analytical skills.

- Lack of fully functional independence in foreseeing and drafting macro-fiscal framework (the revenues part). Accommodation of expenditures stemming from Government decisions and laws with fiscal implications add pressure to increasing forecasting of budget revenues.

- Lack of a rule that determines criteria for inclusion of one-off revenues in fiscal framework. One of the easier ways to accommodate additional expenditures was inclusion of one-off revenues, probability of collection of which was not always known. Although during the past years there was no excess of surplus due to low execution of expenditures, failure to collect these revenues may have caused an excess of surplus and consequently an increase of state debt.

- Forecasting own source revenue of local level by the central level without close consultation with municipalities

**Proposed activities.**- To address the underlying causes for inaccurate revenue forecasts, the following activities will be carried out:
1.1. Publication of the methodology of the economic variables forecast and publication of economic indicators prior to the MTEF and budget proposals: transparency on the methodology and prior publication of economic indicators and the associated revenue forecast may bind the revenue forecast that is included in the MTEF and annual budget. The methodology of forecasting macroeconomic indicators and budget revenues will ensure a complete harmonisation with key macroeconomic indicators measured by the Kosovo Agency of Statistics for baseline forecasting years.

1.2. Macroeconomic unit to become independent in 2017-2018. Independence means the unit will report directly to the Minister of Finance. This would enable better information of the minister and as necessary, of the BFC on the level and accuracy of revenue forecasting.

1.3. Increasing the number of adequate staff (with great analytical skills) as well as keeping existing staff in the macroeconomic unit -2016: Maintaining of existing capacities and completion of the number of staff with adequate and professional staff is one of basic preconditions for drafting a credible fiscal framework and monitoring of fiscal rules that have already been provided by law. In order to enhance the quality of forecasting, new staff should be trained in using different econometric methodologies to analyse the effect of policies.

1.4. Issuing of a regulation that would limit inclusion of one-off revenues 2017-2018: A regulation that would limit possibilities of including one-off revenues without having assurances of their collection would help drafting of a credible fiscal framework. Also, even after including these revenues, there is a need for creation of contingency in the budget which would function as support in case of under collection of those revenues.

1.5. Conducting a consultation process with municipalities in drafting budget revenue forecasting during the budget process..

Priority 2: Effective commitment controls

**Objective of the reform.**- To reduce payment arrears by increasing the compliance with applicable commitment controls.

**Description of the problem.**- Despite the existence of a legal framework, various reports such as internal audit reports, external audit and PEFA report show that budget organizations do not fully comply with the financial rules and procedures. Of special concern are the increasing levels of end-year payments arrears or unpaid bills.

Although it is admitted that debts are not reported duly and correctly, therefore it is difficult to know the amount of bills received by BOs which have not been registered as expenditures in KFMIS yet, SIGMA (2015) estimated the full amount of payments arrears as 5.7% of expenditures of central government in 2013, while an estimate of 2.3% of expenditure in 2014. In both estimates, the amounts are clearly not insignificant. As payments arrears eventually have to be paid off, it will negatively affect public service delivery in future years.

**Root causes.**- The underlying reasons for payment arrears are ineffective commitment controls. BOs are entering into obligations that are not covered by budget allocations resulting in delays in paying invoices. Payment delays would not occur in case BOs would comply to the applicable internal controls (make reference to the applicable regulations for incurring commitments, LPFMR and Regulation on spending the public money).
The causes underlying the ineffectiveness of commitment controls have been laid out in the Public Internal Financial Control Strategy (2015-2019). In brief, although lines of responsibility and accountability are formally in compliance with legislation, they do not provide effective control over public resources and implementing public policies. Head of a budget organization that is responsible for policy implementation has no formal responsibility and accountability for the expenditure of public funds. Certifying Officers have the power to certify the expenditures within the system (KFMIS) that do not comply with commitments, contracts, expiration dates, limits on payment in cash, etc. There is no clear division of tasks between the Chief Financial Officer (CFO) and the certifying officer. The two officers carry out audits and overlapping responsibilities. The Certifying Officer is expected to conduct Treasury controls, but he/she remains an employee under the Chief Administrative Officer (CAO) by doubling the internal controls pertaining to the CFO. This brings the situation where the CFO or other operational managers do not feel fully responsible and accountable for their actions. Also, it is noted that there are no sanctions against officials of the BO’s for violating commitment controls and having belated invoices of more than 30 days.

**Proposed activities.** To address the underlying causes for inaccurate revenue forecasts, the following activities will be carried out. Proposed activities are based on the PIFC Strategy (Public Internal Financial Control) /2015-2019:

2.1 Amendments to the LPFMA/Regulations: These include inclusion of the request that the Head of BO to sign financial statements; presentation of internal control statement signed by the Head of BO, CFO and the BO CFO as part of financial reporting; introducing sanctions for those responsible for omissions in reporting and failure to comply with regulations for expenditure of budgetary resources. Presentation of the request for professional qualifications of CFO.

2.2 Training and capacity building of financial chief executive officer (-s). The role of CFO will be important and their skills will be upgraded to enable them to provide financial expertise and necessary advice for managers in both scope and interpretation of financial and operational information needed to enable reaching manager’s objectives efficiently and effectively.

2.3 Introduction of modified accrual accounting and reporting (commitments and obligations, asset management) with BO's obligation to prepare and submit financial statements. Update and implementation of appropriate accounting methodology.

2.4 Identification and development of control: preparation of standard operating procedures, including descriptions of process and flow charts with the identified controls, such as budget planning, budget implementation, appropriations, commitments, public procurement, management of revenue and expenditure, assets payment and management responsibility.

2.5 Expansion of KFMIS functions: to provide information for management reporting on budget performance and financial analysis of activity to enable managers to assess efficiency and effectiveness.

2.6 Review of the Financial Rule on Reporting of arrears

2.7 Reporting of internal debt by the Debt Unit/Treasury on quarterly basis according to the data provided by the BOs.

2.8 Sanctioning of Budget Organizations by removing access to KFMIS for execution of budget in cases of arrears,

2.9 BOs monitoring through KFMIS and electronic archive,

2.10 Enhancement of capacities in Monitoring Unit.
Priority 3: Sustainable revenue collection

**Objective of the reform.** Expansion of tax base through fighting of fiscal evasion and smuggling of goods.

**Description of the problem.** For taxation, two problems negatively affect the effectiveness of revenue collection.

- A first issue is the tax gap. According to the World Bank report “Public Sector Revenues-Tax policies, tax evasion and tax gap 2014”, the low rate of domestic revenue collection suggests that there is a presence of "tax gap" in Kosovo. In relation to local VAT, tax gap is estimated to be around 34%.

- A second issue is the difficulties in collecting outstanding tax arrears. According to the last report of PEFA 2014, tax arrears are high and the level of collection of arrears is only around 23%. This was confirmed by the IMF Report “TADAT” which considers that management of unpaid tax debts as ‘weak’ and ‘in need of considerable attention’. This report also concludes that poor management of unpaid taxes is combined with failures to write-off un-collectable arrears. Although there was an increase on the number of cases of unpaid taxes until the end of 2012, number of cases for the following years has remained stable.

In order to increase collection of custom duties, issues requiring continuous engagement and resources are tax evasion and smuggling:

- The problem with customs tax evasion (VAT, customs and excise duty) is mainly present because of the fact of non-declaration of real value of goods, non-accurate tariff classification of goods, origin of goods, real quantity and real quality of imported goods.
- Smuggling of goods also remains a continued challenge for Customs. Green border is mainly used for smuggling goods. Insufficient number of officers to patrol secondary roads, difficult mountainous terrain where the border line is poses a problem in itself. Setting higher excise tax comparing to the neighbouring countries also poses a high risk for increased smuggling of goods. These are all some factors that influence directly or indirectly in the development of goods smuggling.
- The fifth issue that concerns total revenue collection (including both tax and customs) is the need to maintain the revenue base in the future. Following the signing of the Stabilization and Association Agreement (SAA) in October 2015, income from trade flows will be reduced and domestic revenue sources need to substitute for border revenues. As a consequence, the amount of trade revenues is estimated to decrease by 25 million Euros in the first year of SAA implementation. Potential domestic substitute is the VAT. This requires VAT collection to be more effective

**Root causes.** At the root of the tax gap is the general prevalence of tax evasion among tax payers and the inability of the Tax Administration Kosovo (TAK) and Kosovo Customs (KC) to identify all tax liable actors and transactions. A more effective organization based on risk management would be better able to identify non-registered businesses non-declaration in order to reduce the level of non-compliance. The TADAT report describes potential room for improvement in various aspects of the TAK and KC.

With regard to the problem of the stock of tax arrears, it is noted that more than half of the "old debt" debt securities are less than 200 €. Collection of these debts is inhibited by the lack of staff capacities
in the regions and the lack of priority to address tax debts from regional offices. Also, efforts for collecting small debt amounts reduce the capacity for the collectable debt.

In order to increase collection of custom duties, issues requiring continuous engagement and resources are tax evasion and smuggling.

**Proposed activities.-** In line with 2015-2020 Strategic Plan of TAK and Kosovo Customs Strategic Plan 2016-2018, the following activities will be carried out to increase the revenue base and ensure effective tax collection:

3.1 Establishment of the Revenue Agency: As per government decision of 22 July 2015, it has been decided to integrate the Tax Administration of Kosovo (TAK) and Kosovo Customs (KC) in a joint revenue agency. The establishment of the Revenue Agency is based on the need to improve services to taxpayers, reduction of the "tax gap" through simpler and more efficient structures of tax collection, increase efficiency in tax collection and reduce costs in the process, increase the autonomy of institutional structures that deal with revenue collection, the establishment of more effective institutional structures for the implementation of tax and customs policies and meeting the necessary criteria for EU integration process.

Implementation of the law of Debt Forgiveness: The Law was approved in August 2015, whereas it is into force as of September 2015, and needs to be implemented during 2016. As these old debts are written off, the unpaid debts position becomes clearer and the emphasis is on the collectable debt.

3.2 Beginning of electronic service e-invoice; The concept of work in this system has been designed in such a way so that every VAT invoice between respective businesses should be electronically signed by the information system in the TAK. Given that no budget was allocated to this project this year, during this year a component of electronic declaration is expected to be developed where all taxpayers could send sales books to the TAK system on monthly basis.

3.3 Modernization of information technology. System Software platform for change management (Change Management Repository - CMR), based on Enterprise Architect platform, was functionalized with the support of the IMF expert. All changes will be based on the TAK strategic objectives which are part of strategic plan 2015-2020.

Depending on tendering, the new system may be put in function at the end of 2017 and in the second half of 2018. The European Commission has pledged 4 million euro, whereas from the Kosovo budget for 2016 are pledged 1.2 million out of 3 million planned for the three year period.

3.4 Increasing staff skills and abilities / Build capacities of Risk Management Division (RMD). The RMD staff is planned to attend internal and external trainings with the purpose of increasing knowledge about modern approaches or strategies to compliance risk management. RMD is working towards advancing different tools to be used with the purpose of identifying risks and better management of risk management process such as: advancement of risk module, ASCI module (Automatic Setting of Controls and Inspectors), then during this year the RMD has made a request for creation of a new software of business intelligence which will be implemented as of 2017.

3.5 Increasing international cooperation on custom issues: to reduce customs-tax evasion, the number of countries with whom there a cooperation agreement to verify values or exchange of data / documentation will be increased.
3.6 Automation of systems and internal customs procedures, by creating new systems/modules, which could directly contribute to increase the level of oversight, efficiency in collection of customs duties domestically and at the border, eliminate the discretion and decision making of officers and at the same time ease and simplify customs procedure.

3.7 Increasing officers’ competence in professional fields and as necessary of businesses by enhancing existing knowledge and skills or new trainings which have a direct impact on proper implementation of customs policies and legislation, thus increasing the revenue collection.

Priority 4: Development of the Medium Term Expenditure Framework (MTEF)

Objective of the reform.- Further advancement of the role of the MTEF as a liaison document between the National Strategy and budget planning for the next three years.

Description of the problem.- In accordance with the LPFMR, the Ministry of Finance drafts the Medium Term Expenditure Framework (MTEF), which is a three-year document that should provide a link between the macroeconomic and fiscal forecasts with Declaration of priorities of Governmental policies which are based on sectoral strategies.

The role of MTEF as a document linking strategic planning and annual budgeting is reduced by the following shortcomings.

The statement of the Government's priorities presented in the MTEF should be brief and present clear priorities that will be funded in the medium term. Currently the statement of priorities of the Government determines many priorities (substantially all the activities possible), not specifying exactly the Government's priorities.

The costs of sectoral strategies should be consistent with realistic budget means and serve as a basis for drafting of the MTEF. In our case, the lack of comprehensive costing of strategies has prevented full compliance of proper costing with medium term expenditure framework.

There is a deviation between the spending ceilings set in MTEF, approved in April, and the final ceilings of the annual budget for Budget Organizations approved in October of the same year. These differences are greater between the second years’ Budget, planning in the MTEF with actual Budget approved in the current year. These differences in planning the budget approved in relation to the ceilings provided in the MTEF exist both at the level of planning by budget organizations as well as on the level of economic classification and programs.

Root causes.- To improve the role of the MTEF document as guiding the budget process, the following underlying causes need to be addressed.

In many cases, sectoral strategies have tended to be treated as separate documents and their costs have not been integrated within the macro-fiscal framework of MTEF.

The first year of MTEF planning provides indicative figures for the annual budget. The two outer years are just repeated minimizing the role of the planning of this document.

By not having any legal provision that provides for the approval of MTEF by the Assembly, budget planning often is subjected to changes by the Government or some ministries. Changes in adjustment of expenses are ad hoc changes which may occur within a short period of time, and these usually occur in capital projects.

Another issue is that neither strategic plans nor MTEF and the annual budget contain assessments of the risk for the most obvious issues such as delays in the implementation of complex projects, gaps in strategy, timely planning of full cost.
Also it is noted that the current practice of MTEF preparation is that each BO submits their own MTEF budget proposal; a sector approach for the MTEF-phase (in which BOs are consolidated into one sector) is absent. Given the high number of (small) budget organizations, the strategic focus and link with the National Strategy is difficult to maintain.

**Proposed activities.** The following activities are proposed to address the weaknesses in the domain of MTEF:

4.1 Operationalization of Steering Group for Strategic Planning (SGSP) according to Government decision No. 11/14, of 18/03/2015, and the Strategic Planning Commission established according to Government decision No.02/70 of 15/01/2016.

4.2 Training on assessment of budgetary impact: In 2015 the Government - MF / Department of Budget has issued Administrative Instruction (AI) 03/2015 on Assessment of budgetary impact on new Government initiatives of the Government which obliged BOs to complete evaluation forms on assessment of budgetary impact for all initiatives that are to be approved in the government, including: draft laws, Administrative Instructions, draft regulations, strategies (and action plans).

While completing forms, the BOs should specifically identify: the aim, objectives, products, activities that identify the cost of new initiative and funding sources (Government grant, Borrowing and donors, etc.).

Application of this A.I. adequately by BOs will reduce the cost discrepancy in the strategies presented in MTEF. Regarding this A.I., the Ministry of Finance will provide training and is able to provide training whenever budget organizations express a demand.

4.3 Preparation of explanatory notes on deviation between the MTEF ceiling and the Annual Budget ceiling: MF will provide detailed information on digression between MTEF and annual budget ceiling through a standardized chart, in compliance with Article 19.1 of the LPFMA (items d and e). The standardized table shall at later stage provide further details on variations at the level of BO's, provided that these variations are above a predetermined minimal amount.

4.4 Risk assessment by Budget Organizations on MTEF planning: Budget circular shall include a standardized form for description and tabular presentation of foreseen risks (such as timely planning of changes according to political decisions, timely planning of costs for capital projects and especially complex projects, and as well as costing gaps in different strategies, etc.) to be filled by BOs.

4.5 Application of a sectorial approach in MTEF preparation: A proposal for a sector approach in MTEF preparation will be prepared. The sector approach will appoint leading sector ministries to which other BOs operating in the sector shall submit the medium term budget planning.

**Priority 5: Annual budget credibility and control of execution**

**Objective of the reform.** Strengthening of annual budget credibility through improvement of annual planning and its credibility, including planning at the level of programs, in order to ensure that budget drafting is in accordance with macro-fiscal framework as well as strategic objectives of the Government.
Description of the problem.- One of key problems identified with respect to credibility of the budget, are high budget values of deviation of current budgetary expenditures in relation to budget planning at the beginning of the year. Such a deviation in expenditure structure in 2014 was result of planning of higher contingent funds (salaries, veterans, etc.), as well as transfers in the last quarter of the fiscal year that were allowed through the Annual Budget Law, Article 13.2. Another main problem in budgeting is that BOs still plan their budget based on economic and administrative classification not based on programs / policies. This makes the budget less flexible and it lacks information on performance indicators. Another shortcoming are issues related to training of the BOs’ staff in relation to using two systems for budget planning (BDMS and PIP), in particular training of new staff, etc. Measures for risk reduction are not foreseen and problems have been solved on ad hoc basis by reflecting in expenditure cuts wherever possible. Most of planned activities and particularly new activities with considerable costs have been modified, changed, suspended or budgetary year has ended with considerable obligations.

Root causes.- One of the reasons for lack of credibility of budget is optimistic forecasting for budget revenues that resulted in continued review of expenditures. Overly optimistic forecasting identified during 2015 have damaged budgeting process by creating an urgent and unforeseen need for adjustment both in expenditure and revenue plans. This issue has already been addressed in Priority 1. Another key problem in preparation of annual budget is political influence that impacts changing of the budget with the purpose of realizing certain policies, and this has an impact both in the structure of the budget for BOs and also in changing budget ceilings for certain budgetary organizations and in general in total budget. It should be noted that transfers within a year are not contrary to budgetary rules. Article 30 of the LPFMA allows comprehensive administrative transfers within budget organizations (25%) in order to transfer budget financing between negatively impacted budget line allocations without needing to inform the Assembly. Apart from this, Article 14.2 of the Law on Annual Budget 2016 enables the Government to transfer funds from BOs up to 5% of the overall annual budget without prior approval of the Assembly. Flexibility provided by these two legal provisions has a negative impact in budget credibility and makes correct budget assessment in the planning stage less urgent. This room for flexibility may be linked to lack of cooperation among senior management, which means that there should be greater engagement and cooperation, from the very beginning of budget planning, between political staff (cabinet of ministers) with chief administrative officials and chief financial officers of the BOs, in order to conduct harmonization of BOs policies with the budget. As a consequence of lack of cooperation during planning and execution of the budget, there are many movements in the budget such as re-allocations in programs / sub-programs and in economic categories.

Proposed activities.- With the purpose of improving budget credibility, following activities are suggested:

5.1 Drafting of administrative instruction for transfers – re-allocations: AI determines clear criteria related to justification of transfers – re-allocations in compliance with Article 30 of the LPFMA and Article 14 of the Law on Annual Budget. It also determines the list of additional documents to verify reasoning of these requests by ensuring that deviations from budgetary structure, irrespective of value, are conducted only in cases of directly filling in of positions as defined by Law.
5.2 Program based budgeting: A model of program based budgeting will be established for the Ministry of Finance for 2017. Depending on results, the model will be expanded to other budget organizations. Possible benefits from program based budgeting are transparency about relation between budget allocations and results.

Priority 6: Quality of information on capital budget

Objective of the reform.- A more efficient and effective management of planning and monitoring of public investments by budget organizations in PIP system, which will impact the proper planning of capital projects that should be interrelated to National Development Strategy and Government priorities.

Description of the problem.- Capital projects are planned through the system of Public Investment Program (PIP). During the budget planning process, all BOs are obliged to present their requests for capital projects through PIP system, and have to complete information for each capital project as required by the PIP system. They should also complete Cost/Benefit analysis. Budget Organisations are obliged to report every three months, through PIP system, about the financial plan and physical progress of the project during its implementation. Information is reviewed by the Budget Department in the Ministry of Finance.

The role of MoF remains limited in selection and prioritization of capital projects, while the work of Public Investment Committee (PIC), established in 2010, in evaluation and selection of projects is considered inefficient. The Government decision No.02/70 of 15/01/2016 repealed the decision for establishment of PIC and established the Strategic Planning Committee¹ that would lead the process of Integrated Planning System in Kosovo, and inter alia will be responsible for strategic review of capital investments.

When planning of capital projects, budget organizations fail to provide complete and correct information about the project, which is required by PIP. Some of these shortcomings noted during capital projects planning in PIP system include:

- Lack of cost/benefit analysis of big projects (over 1 million euro);
- Incorrect planning of project assessment which implies changing of total cost of planned project with the total cost of accomplished project.
- Incorrect information regarding cost of projects divided in capital and operational which impacts the underestimate of overall cost of capital project.
- Planning of projects in the category of capitals that pertains to operational expenditures nature.

Root causes.- Some of the issues causing shortcomings have been provided below:

Although progress has been achieved in improving/enhancing PIP system, the system is not being sufficiently used by budget organizations for planning and monitoring needs. This is mainly due to lack of adequate regular training in the use of PIP system.

Political influence is one of the factors with negative impact in planning of capital projects, especially following budget approval by the Government. Projects with smaller monetary values than they really cost are introduced in parliamentary committees of the Assembly of Kosovo.

One of the problems is also lack of cooperation between senior management meaning engagement and cooperation from the very beginning of planning of the budget for capital expenditures between

¹ Permanent composition of the Strategic Planning Committee: 1) Prime Minister, Chairman
political staff (cabinets of ministers) with chief administrative officers and chief budget and finance officers of BOs.

Another issue is that the structure of the budget is limited and no flexibility is allowed in changing economic categories which influences in the categorization of some projects that are not clearly defined as capital expenditures.

Currently, the Budget Department for PIP system lacks sufficient staff to deal with maintenance and further development of the system and verification of information that BOs have entered into the PIP system. During budget planning and execution, there might come up different ad hoc requests for development in the system from higher political levels, technical requirements, or other, which in future might pose a serious problem in the functioning and development of the system.

Another specific issue at the level of local government is that for most projects the capital budget is shared among several programs and instead of being managed by the relevant programs that are managed by a single program. This practice does not allow respective management and control over the capital investment planning and implementation.

**Proposed activities.-** Following activities are proposed to treat improvement of the quality of information on capital investments:

6.1 Further strengthening of the role of Budget Department and MoF in evaluation and selection of projects and in creating a mechanism to control the quality of data entered by the BOs into the PIP system.

6.2 Organisation of training for PIP system: To organise Training for all users of PIP in the area of planning of capital projects as well as monitoring module.

6.3 Issuing an instruction that clearly defines what should be treated as capital project (definition) that obliges budget organizations, while planning projects, to separately present operational costs during realization of the project and following its completion.

6.4 Maintenance of PIP system: to increase number of staff that will do maintenance, development and review of functions in the PIP system according to needs and presented requests.

Priority 7: Public procurement

**Objective of the reform.-** Ensuring efficient, transparent and correct use of public funds as well as realization of the main principle in public procurement “value for money”.

**Description of the problem.-** Incomplete information on capital and operating costs and thus underestimating the costs of new capital projects.

Law 05/L-068 on amending and supplementing Law 04/L-042 on Public Procurement of the Republic of Kosovo, amended and supplemented by Law 04/L-237, ensures more efficient, transparent and correct use of public funds, public sources and other funds and sources of contracting authorities in Kosovo by basing public procurement in key principle of “value for money”. PEFA and SIGMA stress that the quality of law is in compliance with best international practices and the EU Acquis.

However, during the implementation of the Law no. 04/L-042 on public procurement in practice, some shortcomings and difficulties were noted in its implementation or even in its proper application. The
last report of General Auditor says that public procurement has seen limited progress, with shortcomings being repeated in all procurement stages and improvement of the system remains a challenge for the Government of Kosovo in future.

Other international reports (PEFA, SIGMA) suggest strengthening of capacities and ensuring of proper functioning of public procurement bodies, in particular through duly appointment of members of competent boards. Those reports also request improvement of implementation of public procurement processes by proper use of tendering procedures, centralized purchases and development of electronic procurement. Also the need to remove preferential treatment for local bidders was stressed.

**Root causes.**- In relation to addressing the issue of non-compliance and comments of international observers, amendments to the law have already been proposed and the amended Law no. 04/L-042 on Public Procurement was approved by the Assembly of Kosovo on 14 December 2015 and entered into force on 21.01.2016. The amended law provided a better legal basis that refers to tenders, issues of the boards, internal and external conflicts, deadlines for complaints, preferences for local companies, centralized procurement, common terminology for public procurement, harmonization with budgetary codes, training issues, harmonization of domestic legislation with the new EU Directive on Public Procurement, the system of e-procurement as well elimination of preferences for local bidders, regardless the fact that the SAA sets time limits for elimination of these advantages. Implementation of amended law will be a challenge. In this context, national procurement strategy and its action plan have been drafted and they should be approved with the purpose of developing the public procurement system.

Main problems raised during the implementation of PPL are: inadequate planning of public procurement, use of non-updated public procurement procedures, inadequate evaluation of bids, setting of abnormally low process which creates huge problems in execution of contracts, limited knowledge on public procurement among contracting authorities, economic operators, public procurement institutions and citizens in general; inadequate management of public contracts by contracting authorities, mainly assigning inadequate managers for the area that they cover, for the purpose of managing their implementation; unclear specification of types of contracts and their precise deadlines, non-specification of deadlines for execution of contracts, setting discriminatory criteria. Through e-procurement, there will be an increase of transparency, efficiency, cost-benefit, reduction of administrative barriers, higher accountability, etc. The use of electronic system guarantees a transparent process and ensures conditions for an open and fair competition between participating economic operators.

In addition to other monitoring, the PPRC has started to monitor all notices prior to their publication on the PPRC website (contract notice, contract award notice, contract signing notice, notice on cancellation of contract notice, notice on public auction, etc) and for all values without any exception, this monitoring is done in order to prevent and eliminate eventual omissions which can occur in the very beginning of implementing the activity, like elimination of discriminatory criteria, non-measurable criteria, than it looks at defining tendering deadlines, contract duration, quantities, proper use of procedure, etc.

**Proposed activities.**- In compliance with national procurement strategy and its action plan, following activities are proposed:
7.1 Establishment of e-procurement system to conduct procurement activities: E-procurement systems will have modules for:
- E-tendering
- E-contracting
- E-complaints
- E-contract management

7.2 Development and implementation of centralized procurement activities: centralized procurement and use of framework contract may simplify procurement about small items or regularly procured items. The practice of these advanced forms of procurement will be intensified. This activity entails the need for additional staff.

7.3 Monitoring of public procurement activities: monitoring of procurement activities aims at achieving elimination of shortcomings and non-observation of Law on Public Procurement. In compliance with the strategic plan, more attention will be paid to monitoring of contract management. The nature of contract monitoring and procurement activities necessarily requires engagement of additional staff, including local experts such as architects, engineers, etc.

7.4 Raising the awareness of wider public regarding the rules of public procurement: Increased awareness about public procurement will change public perception and reduce chances for abuse, and reporting of abuses will be fairer and more efficient.

7.5 Training of procurement officers: Basic and advanced trainings should be held, including training regarding e-procurement, with the purpose of enhancing knowledge of procurement officers.

Priority 8: Strengthening internal audit

Objective of the reform.- Strengthening the function of internal audit as value added services towards accountable management.

Description of the problem.- Although PEFA report positively assesses the situation in internal auditing, there are some issues that should be addressed in order to ensure effective and sustainable functioning of internal auditing. These issues have been well presented in the Strategy on Internal Control of Public Finances (2015-2019).

Firstly, there are some budget organizations that are small concerning budget, operations, employees and scope of public services, which have established the function of internal auditing. Based on criteria on internal auditing which derive from the LPFMA, every budget organization, irrespective of its size, should establish auditing commission where there is an established internal auditing unit, even if it operates with one internal auditor and small amount of budget, transactions and few staff.

Secondly, training of internal auditors is the mandatory part of the profession, until now, trainings were supported by the European Union through different projects. These trainings involve most of internal auditors, depending on their recruitment and internal auditors. Currently there are about 50% internal auditors internationally certified by CIPFA UK, 40% of auditors are in certification process and 10% are new auditors that were recruited after trainings. According to current information we possess, European Union will not support further programs for training and certification of internal auditors.
Thirdly, despite that there are rules for implementation of recommendations according to assessment of PEFA, SIGMA, Central Harmonising Department, internal auditor, external auditor they are not addressed at the adequate level by the management.

**Root causes.**- The establishment of audit committees in each budget organization regardless of size, staffing and the volume of transactions and units of internal audit with only one internal auditor is creating a cost which is not very effective and efficient when compared with their cost / benefit. The audit profession is a profession which constantly needs to be in trends to follow best professional standards and practices, and Kosovo has not yet established a local scheme for training of internal auditors, as the training of internal auditors is supported by the European Union. Although controls are established for implementing auditor’s recommendations they do not function properly. Auditor’s recommendations have not been implemented due to the lack of managerial responsibility.

**Proposed activities.**- The proposed activities are based on PIFC Strategy /2015-2019:

8.1 Revise the Law on the internal audit function: The Law needs to rationalize the internal audit function by reducing the number of units with an internal auditor and adding internal audit coverage. Either this is legally laid down in an Amendment of LPFMA or it is included in a new PIFC Law.

8.2 Update Internal Audit manual: the update should (i) expand the scope of auditing - performance audits, IT system audits, system audits; (ii) include a mentoring scheme; (3) establish risk registries in audit annual plans; (iv) establish mechanisms for cooperation between Internal Audit Units with line managers for selection of high risk areas for audit and provide advice and recommendation.

8.3 Establish a Local Internal Auditors’ Certification Programme and train internal auditors according the local certification scheme.

8.4 Training of internal auditors on auditing EU funds: Establishment of auditing capacities to audit projects funded/co-funded by the EU (selection and training of internal auditors to audit EU funds).

**Priority 9: Strengthening external audit**

**Objective of the reform.**- Develop a well performing Supreme Audit Institution, which conducts audits in accordance with internationally recognized public sector auditing standards.

**Description of the problem.**- The external assessments done by PEFA and SIGMA report both positively on the performance of the Office of the Auditor General. The OAG is still a young organisation and there is ample room for improvement towards compliance with the international standards for supreme audit institutions (ISSAI).

In line with the fundamental expectations laid upon Supreme Audit Institutions as stated in ISSAI 12, the following weaknesses are identified:

- Strengthening the accountability, transparency and integrity of government and public sector entities
- Lack of knowledge about consequences of creation of PFM system based on “COSO” principles, its organizational influence and steps to be undertaken;
- Audit recommendations not addressed fully as expected;
- Modernisation of audit approaches and tools still a challenge. Performance audit is still not much developed.
- Demonstrating on-going relevance to citizens, Parliament and other stakeholders:
  - Limited support in drafting and implementing reforms for our stakeholders;
- Being a model organisation through leading by example
  - Opportunity to manage continuous change;
  - The ownership of overall corporate values, and individual generic competencies and attributes not fully secured

**Root Causes.** - The main causes that underlie the weaknesses:

- A. Strengthening the accountability, transparency and integrity of government and public sector entities;
  - Lack of a law fully ensuring AG functional independence;
  - Absence of a new appointed AG with the mandate and ability to address the strategic challenges in a sufficient way;
- B. Continuous demonstration of the importance of auditing to citizens, assembly and other stakeholders; Still little chance for generalization in relation to reforms;
  - The quality of the audit and communicating its results not fully in line with the ISSAIs;
- C. Being a model organisation through leading by example;
  - Lack of modern management approaches across the institution:
  - Lack of curiosity and in depth understanding of our corporate overall values, individual generic competencies and attributes;
  - Lack of skills and expertise in certain areas;

**Suggested activities.** - To address the weaknesses, the following activities are proposed:

9.1 Secure institutional independence: The amended legal framework is adopted by the Assembly and a new Auditor General that assures the independence of the OAG is appointed.
9.2 Address the gap between OAG audit practice and the ISSAIs: As a first step, an assessment based on the SAI Performance Measurement Framework (SAI-PMF) is carried out. The SAI PMF covers the relevant ISSAIs for the institutional mandate, the organizational and management practices and the quality of the audit work. It especially addresses the issue of audit quality management. Based on this assessment a strategy for further institutional capacity building will be prepared.
9.3 Regularity Audit Guidance: the OAG regularity audit guidance and methodology will be further updated to comply with the international standards and quality expectations. This guidance will treat the methodology of financial auditing and compliance.
9.4 Further development of OAG practice for performance auditing: guidance on performance auditing will be updated in compliance with international standards. It will include IT auditing as well.
9.5 Communication with the Assembly: In order to increase the impact of the audit work, the OAG is committed to further develop the relationship with appropriate contacts in the Assembly (Budget and Finance Committee and the Committee for Oversight of Public
Finances) on one hand and BFC/COPF and Parliament on the other using OAG’s findings to hold the government accountable.

Priority 10: Enhancement of IT systems

Objective of the reform.- Enhancement of IT systems operational at the Ministry of Finance to improve quality of financial information.

Description of the problem.- A number of IT issues can be mentioned:

The MoF uses several separate information technology (IT) systems to manage the budget: Budget Development Management System (BDMS), Public investment Planning system (PIP), Kosovo financial management information system (KFMIS), Payroll information system, E-procurement, E-assets. These IT systems are not appropriately linked which is increasing the workload and the risk of error with multiple manual insertions of data. Is has resulted in a lack of a reporting system with integral and reliable data from different systems.

Treasury is responsible for the management of all information technology equipment including eight information systems that are used by the Treasury. Treasury has constantly supported around 80 users of Treasury with IT equipment and over 1400 users of KFMIS, who exclusively use Treasury equipment to have access to KFMIS and other Treasury systems. However, the KFMIS infrastructure is over 11 years old and the equipment to maintain the system is no longer in production. In view of the risk of failure in their operation and inability to support the x64 bit infrastructure, its replacement with new infrastructure is required.

The Ministry of Finance should complete implementation of Electronic Archive (Archive digitalization) which would serve to archive copies of invoices and financial documents the moment expenditures are posted in KFMIS.

Treasury/ MF has the chance to fully exercise the function of monitoring by creating the level of control also in relation to exact implementation of financial rules on spending public money, but also by following the level of payment arrears caused by BOs.

Root cause.- IT systems in Kosovo have been developed in fragmented manner during 2000-2014, whereby different donors and projects helped with separate systems. For example, systems on budget management (planning and execution) have been developed in different platforms (Oracle, PHP, MSQQL, Progress SQL, etc.) and are not related to one another and this results in lack of uniformed and credible reporting.

In the past, the option for an integrated financial management information system has been discussed by the IT Steering Group and compared to the alternative of better linking the existing systems. As an integrated solution would be rather costly and complex to build, the IT Steering Group has so far opted for upgrading the existing systems and to install better inter-linkages through a data warehouse which is linked to each application.

Proposed activities.- To facilitate public finance management by better IT systems, the following activities are proposed:

10.1 Integration of Budget Management systems by establishing a data warehouse. The solution of a data warehouse will be realized through the following steps: (i) Documentation of
needs and work processes, (ii) Development of Terms of References for systems integration, (iii) completion of procurement procedures and Initiate the development of data warehouse, (iv) Completion of development data warehouse; (v) Integration of systems or development of interfaces and (vi) Development of the reporting system.

10.2 Modernizing of information technology within Treasury: there should be an increase of hardware capacities and full operationalization of data centre and continuation of work in case of disasters. Equipment should be bought during 2015-2018.

10.3 Establish a decentralized electronic archive by Budget Organisations: Provision and purchase of necessary equipment for end points shall be done by the BO’s with own financial means, whereas the Treasury will provide necessary instruction for compatible equipment needed for access to this system. By implementing this project, the Treasury will manage to store and preserve all financial documents in electronic format, regardless of BO’s location and activity. In addition, the Treasury shall have access to the documents and stored data, which will be used for analysis and various verifications for the BO’s by the Treasury. From the moment of delegation of spending authority from the Treasury to the BO’s, Treasury, i.e. Ministry of Finance can monitor financial transactions only in the aspect of entries into the KFMIS.

Priority 11: Budget transparency

Objective of the reform.- Ensuring compliance of information about Kosovo budget with the IMF / GFSM standard 2014. Revision of charter of accounts to be conducted in the order to harmonize it with GFSM 2014, and then budget planning and execution process to be conducted according to that charter of accounts.

Description of the problem.- PEFA and SIGMA are generally positive on the degree of budget transparency demonstrated by Kosovo. One weakness is the inability of Kosovo to report it government financial information fully in line with the GFSM 2014 standard. Kosovo Government has so far not had resources or a strategy for reporting based on the manual of Governmental Financial Statistics. Taking into account that Kosovo is member of the IMF, it is expected that Kosovo reports and has statistics published in the GFS year book according to GFSM 2014.

Information on Governmental Statistics of Republic of Kosovo enables transparency and opportunity for fiscal analysis. Reporting in accordance with GFS enables policy makers and analysts to study financial operations of the government and financial position of the government. Kosovo as IMF member reported for the first time about the period 2012-2014 according to GFSM 2001. However, it could not deliver all the information in line with the GFS 2001 standard.

Root causes.- Until now there was no official document for sectoring the General Government according to the GFSM requirements. The current Chart of Accounts is not fully compatible with GFS 2001.

Proposed activities.- The following activities are proposed:

11.1 Modify KFMIS or creation of a specific tool to allow automated generation of budget reports in accordance with GFS categorisation.
11.2 Review of government Chart of Accounts
11.3 Structure of Chart of Accounts will be reviewed and a new Chart of Accounts harmonized with IPSAS and GFS will be approved and incorporated into the KFMIS.
11.4 The manual on Governmental Financial Statistics will need to be translation into Albanian so that staff can be trained in the implementation of the new COA.
11.5 Publication of time series of revenues and expenditures of general government.
11.6 Publication of Citizen Friendly Budget. Being that proper and systematic information of citizens on budget policies and projects is key, the publication of Friendly Budget is considered as a good opportunity to inform common citizens about budget policies. Friendly Budget document will be an additional document alongside Budget Law and budget tables. This would be a simple description that will avoid using redundant professional terms and numbers in order to be easier understood by citizens.

Priority 12: Sustainable capacity building in PFM

Objective of the reform.- Achieving systematic, sustainable and integrated manner of enhancement of capacities of civil servants in Public Finance Management by using domestic expertise of public administration and external one.

Description of the problem.- One of the prerequisites of a successful performance in Public Finance Management (PFM) are obviously the capacities of human resources. External evaluations (PEFA, SIGMA) have identified the need for establishment of specific knowledge as evaluation of budgetary impact of initiatives and policies, new knowledge about risk analysis, utilization of information technology systems that are currently in use and those that are to be installed for the first time (BDMS, Balance, PIP, Balance, ATK, DK, etc.), establishment of structures for implementation of decentralized EU projects (DIS), on implementation of reviewed accounting plan, etc.

In various fields such as Audit and Financial Management and Control (training and certification), Public Procurement (with an emphasis on e-procurement), ATK (modernization of the information technology system, etc.), continuous increase of knowledge is even more defined by legislation. Accordingly, all priorities included in this public finance management reform strategy, ranging from macro-economic forecasting, Public Investment Planning, procurement, internal control require adequate human resources in quantitative and qualitative terms.

Root causes.- Now, capacity building in the field of PFM is fragmented as there is no systematic way by which the Ministry of Finance can organize the capacity building efforts. The most important mechanism for knowledge transfer has been through technical assistance projects and twinning programs with similar organizations in the EU. Existing expertise gained by experienced civil servants to present to colleagues through "Training of trainers" has not been used. As there will be less focus on technical assistance projects in the future and possibly more support via sector budget support, there is a need to organize capacity building in public finance management in a more systematic and sustainable manner.

So far, the Kosovo Institute for Public Administration (KIPA) has not managed to offer enough programs in the domain of public finance management.
Proposed activities.- To address the need for systematic and sustainable PFM training, two options are proposed:

I. As a possible first option would be to apply the best experiences in countries in the region, but also in the EU, which show that the organization of training in the domain of public finance management is carried out under the responsibility of the Ministry of Finance in a form of the school for excellence in PFM. Such a school would operate with a small staff for logistical work whereas, for each training trainers will be initially invited from the ranks of civil servants, and in the absence external expertise would be engaged.

II. The second option would be to use the Kosovo Institute for Public Administration (KIPA). Currently many of the programs that have been identified as necessary to increase the knowledge in the area of PFM are not currently offered by KIPA. Using KIPA would require coordination of the work of KIPA with the Ministry of Finance in order to establish a program and curriculum to increase knowledge in the field of PFM.

III. Third option will be based on trends and practices where the training and certification of civil servants is conducted by professional accredited and functionally independent institutions. This would imply using expertise of the said institutions.

The following activities are proposed:

12.1 Preparation of a curriculum for Public Finance Management: Based on existing training programs in the domain of PFM and new requirements, a curriculum is developed.

12.2 Preparation of a cost/benefit analysis): Cost and benefit analysis will compare option 1 (separate PFM school under the Ministry of Finance), option 2 (organization of PFM training under KIPA) and decide accordingly and option 3 (organization of civil servants training and certification by professional accredited and functionally independent institutions).

12.3 Implement option 1, 2 or option 3.

Chapter 4 Institutional organization

4.1 Public Administration Reform

Since the management of public finances is one of the three pillars of Public Administration Reform (PAR), institutional structures for implementation of PFM reform strategy will be in line with structures for the PAR.

Main elements of the structure of institutional management in relation to Public Administration Reform (PAR) were determined by the Government through Government Decisions 05/09 and 09/13. Based on these decisions, the main political/ministerial mechanism for management and monitoring of overall reform of public administration in Kosovo is the Council of Ministers on Public Administration Reform. The Council is chaired by Minister of Public Administration and is composed of Minister of Finance, Minister of European Integrations, Minister of Local Government Administration, Minister of Trade and Industry and a political representative from the Office of the Prime Minister.
The Council is responsible for governing and monitoring of all processes interrelated to the process of implementation of Public Administration reforms.

- It reviews periodical reports on PAR implementation.
- Suggests the review of PAR strategic documents in the Government.
- Deals with implementation of strategic documents.

The second or the administrative level of monitoring, coordination and responsible to ensure implementation is shared by three institutions:

1. The Office of the Prime Minister is responsible for reforms related to development and coordination of policies and legislation coordinated by the Secretary General of the OPM.
2. The Ministry of Public Administration responsible for civil service, provision of services, accountability and organization of Public Administration, which are coordinated by the Secretary General of the MPA.
3. The Ministry of Finance responsible for reforms related to the Public Finance Management, which are coordinated by the Secretary General of the MF.

Department of Management of Public Administration Reform is responsible to monitor and report relating to implementation of all strategic documents related to PAR. It provides information to the Minister of MPA/Chairman of CMPAR in relation to PAR implementation, drafts reports for PAR coordinators, proposes the agenda for the CMPAR, formulates conclusions as well as exercises the role of the CMPAR Secretariat. But the responsibility to implement and report on respective areas/pillars of the OPM and the MF will lie with the General Secretariat and the respective minister. CMPAR is responsible to ensure that all PAR pillars create coherent monitoring and reporting systems, meaning that models and reporting methodology determined by the MPA will be valid for all pillars and all reporting institutions throughout the same time lines.

### 4.2 Monitoring and reporting of PFM Reform strategy

In compliance with Government Decisions 05/09 and 09/13, Ministry of Finance is responsible for reforms related to Public Finance Management.

In order to monitor implementation of the PFM Strategy, a Coordination Group for the PFM, which is an administrative inter-institutional structure led by the MF Secretary General, will be established. The Table below links priorities of PFM reform strategy with Units or/and Departments as members of the Coordination Group.

<table>
<thead>
<tr>
<th>Priority</th>
<th>Description</th>
<th>Responsible Ministry/Department</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority 1.-</td>
<td>Accuracy of macroeconomic indicators and revenue forecasting</td>
<td>Ministry of Finance, Department of Economic and Fiscal Policies</td>
</tr>
<tr>
<td>Priority 2.-</td>
<td>Effective control of commitments</td>
<td>Ministry of Finance, Department of Treasury</td>
</tr>
<tr>
<td>Priority 3.-</td>
<td>Sustainable revenue collection</td>
<td>Tax Administration of Kosovo</td>
</tr>
<tr>
<td>Priority 4.-</td>
<td>Development of Medium Term Expenditure Framework (MTEF)</td>
<td>Ministry of Finance, Budget Department</td>
</tr>
<tr>
<td>Priority 5.-</td>
<td>Annual budget credibility and execution control</td>
<td>Ministry of Finance, Budget Department</td>
</tr>
</tbody>
</table>
Priority 6.- Quality of information on capital budget | Ministry of Finance, Budget Department
--- | ---
Priority 7.- Public Procurement | Public Procurement Regulatory Commission of Kosovo
Priority 8.- Strengthening internal audit | Ministry of Finance, Central Harmonization Department
Priority 9.- Strengthening external audit | Office of General Auditor
Priority 10.- Improvement of IT system integration | Ministry of Finance, Department of IT
Priority 11.- Transparency on budget | Ministry of Finance, Department of Treasury
Priority 12.- Sustainable capacity building in PFM | Ministry of Finance, Department for European Integration and Policy Coordination

This group will monitor and coordinate implementation of this Strategy and the Action Plan. This Group will report about the progress every six months and every year to the Council on PAR, whereas the Council on PAR will report to the Government regarding the progress on annual basis. Annual report on implementation of the reform will become public following its approval by the Government.

**Figure 1: The Structure on PAR management and monitoring**

Monitoring of the progress will be based on indicators. Action Plan contains indicators for 12 priority objectives and achievements for activities. Specific definition and method of measurement will be elaborated further in “Indicator Passport”. Indicator Passport will also include a risk assessment for reaching the objective for every indicator/achievement. Monitoring and reporting should also be coordinated with monitoring and reporting on Strategy on Internal Control of Public Finances since many elements of these two strategies are linked and complementary.
Coordination Group will lead the PFM policy dialogue with relevant external stakeholders. The PFM Policy Dialogue will serve as PAR strategic and coordination mechanisms.

4.3. Medium-term review of PFM Strategy

Action Plan 2016-2018 will be updated on annual basis. The PFM Strategy will undergo a medium-term and a final assessment. Thus, together with the report for 2018, the MF will engage in the process of medium-term assessment of objectives, goals and indicators. The medium-term and final assessment of the Strategy will be focused on following aspects:

- Implementation of the Strategy and the Action Plan (effectiveness);
- Adaptation of interventions in order to achieve desired results and objectives (relevance);
- Adaptation and efficiency of PAR managerial structure (efficiency).

The process of assessments and reviews about the PAR Strategic Framework will be interrelated with external PAR reviews and assessments such as PEFA, SIGMA and assessments of other organizations.

Chapter 5 Financial impact of the strategy

5.1 Overall assessment of costs of activities

The assessment of financial impact of strategy implementation is based on assessment of costs of implementation of Action Plan of the Strategy for the period 2016-2018. This approach was followed with the purpose of ensuring close links between planning of needs and resource’s projection within the Medium-Term Expenditure Framework 2016-2018, and with the purpose of ensuring a realistic covering of the strategy with funds, by organically linking strategic planning with financial and budget planning, in the framework of the public finance reforms.

The assessment of costs of activities was carried out through detailed assessment of the process of potential costs for all necessary sub-activities or milestones that should be realized for implementation of each activity. This assessment was carried out by each institution that has the main responsibility for realization of foreseen activities. The total estimated funds for implementation of Strategy actions during the period 2016-2018 are foreseen to be about **19.9 million Euros.**

<table>
<thead>
<tr>
<th>Policy pillars</th>
<th>Approximate cost (Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pillar 1 Fiscal Discipline</td>
<td>13,162,200.05</td>
</tr>
<tr>
<td>Pillar 2: Allocation efficiency</td>
<td>632,595.40</td>
</tr>
<tr>
<td>Pillar 3: Operational efficiency</td>
<td>1,668,881.37</td>
</tr>
<tr>
<td>Pillar 4: Cross-cutting PFM issues</td>
<td>4,406,230.00</td>
</tr>
<tr>
<td>Total</td>
<td>19,869,906.82</td>
</tr>
</tbody>
</table>
It should be stated that although the estimated cost of the strategy is about 19.9 mil Euros, its implementation along the years may have a slightly higher financial impact that it is estimated. This is because for some of the activities foreseen at the moment of drafting of strategy was impossible to estimate the accurate cost of their implementation, since preliminary assessments or studies are needed in order to implement them further. Such activities are mainly related to investments in information technology systems, training programs or with the review grading system in the new administration established by merging the customs and Taxes.

The reform on the area of taxes and customs will be one of the most important reform to be undertaken in the coming years. These government policies are also reflected in high amount of funds required for implementation of specific reforms and certain activities within the Strategy.

As presented by the above provided data, the largest part of financing will have to be carried out in Pillar 1: Fiscal Discipline, which is estimated to be around 66.24% of all needs for financing of the strategy for the three-year period.

**Chart 1: Specific cost weight by Pillars in %**

Also, as mentioned in previous chapters, the Government aims at increasing efficiency, effectiveness and transparency towards public finance management, both through improvement of systems of administration, but also through investments for modernization of current systems of Information Technology.
The strategy envisages that public finance management reforms should be realized through 12 strategic priorities. Among the twelve priorities, heaviest specific weight in financing the strategy is carried by Priority 3: “Sustainable revenue collection” the realisation cost of which represents in total 63% of the entire financing of the strategy or calculated as 12.5 mil Euros. The large amount of financing for this priority is linked with very big investments that will be foreseen to be made by the Government related to development of new information systems.

Table 2 below presents the assessed needs for financing reforms by each priority and broken down by nature of expenditures.
Table 2: Expenditures by priority ad by nature of expenditures (economic classification in EUR)

<table>
<thead>
<tr>
<th>Priorities</th>
<th>Salaries and insurance</th>
<th>Training, workshops</th>
<th>Technical assistance</th>
<th>Office equipment</th>
<th>Publications</th>
<th>Investment in ICT</th>
<th>Other costs</th>
<th>Total</th>
<th>% of each priority against the total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority 1: Accuracy of revenue forecasting</td>
<td>96,000</td>
<td>-</td>
<td>108,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>204,000</td>
<td>1.0%</td>
</tr>
<tr>
<td>Priority 2: Effective control of commitments</td>
<td>21,600</td>
<td>35,600</td>
<td>105,000</td>
<td>-</td>
<td>-</td>
<td>240,000</td>
<td>-</td>
<td>402,000</td>
<td>2.0%</td>
</tr>
<tr>
<td>Priority 3: Sustainable revenue collection</td>
<td>1,000,000</td>
<td>19,000</td>
<td>387,000</td>
<td>-</td>
<td>-</td>
<td>11,150,000</td>
<td>-</td>
<td>12,556,000</td>
<td>63.2%</td>
</tr>
<tr>
<td>Priority 4: Development of medium term expenditure framework (MTEF)</td>
<td>-</td>
<td>111,433</td>
<td>60,250</td>
<td>-</td>
<td>-</td>
<td>6,000</td>
<td>-</td>
<td>177,683</td>
<td>0.9%</td>
</tr>
<tr>
<td>Priority 5: Credibility of Annual Budget</td>
<td>-</td>
<td>-</td>
<td>276,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>100,000</td>
<td>376,000</td>
<td>1.9%</td>
</tr>
<tr>
<td>Priority 6: Quality of information of capital budget</td>
<td>57,600</td>
<td>11.812</td>
<td>-</td>
<td>2,500</td>
<td>-</td>
<td>-</td>
<td>7,000</td>
<td>78,912</td>
<td>0.4%</td>
</tr>
<tr>
<td>Priority 7: Public Procurement</td>
<td>309,000</td>
<td>301,490</td>
<td>240,000</td>
<td>17,850</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>868,340</td>
<td>4.4%</td>
</tr>
<tr>
<td>Priority 8: Strengthening internal audit</td>
<td>-</td>
<td>59,662</td>
<td>40,000</td>
<td>-</td>
<td>2,000</td>
<td>-</td>
<td>500</td>
<td>102,162</td>
<td>0.5%</td>
</tr>
<tr>
<td>Priority 9: Strengthening external audit</td>
<td>105,000</td>
<td>139,880</td>
<td>451,500</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2,000</td>
<td>698,380</td>
<td>3.5%</td>
</tr>
<tr>
<td>Priority 10: Improvement of IT systems</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>240,000</td>
<td>-</td>
<td>3,955,900</td>
<td>-</td>
<td>4,195,900</td>
<td>21.1%</td>
</tr>
<tr>
<td>Priority 11: Transparency of budget information</td>
<td>-</td>
<td>1,830</td>
<td>70,000</td>
<td>5,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>76,830</td>
<td>0.4%</td>
</tr>
<tr>
<td>Priority 12: Sustainable capacity development in PFM</td>
<td>-</td>
<td>-</td>
<td>125,500</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>8,000</td>
<td>133,500</td>
<td>0.7%</td>
</tr>
<tr>
<td>total</td>
<td>1,589,200.00</td>
<td>680,706.82</td>
<td>1,863,250.00</td>
<td>260,350.00</td>
<td>7,000.00</td>
<td>15,345,900.00</td>
<td>123,500.00</td>
<td>19,869,906.82</td>
<td></td>
</tr>
<tr>
<td>% of each spending against the total</td>
<td>8.0%</td>
<td>3.4%</td>
<td>9.4%</td>
<td>1.3%</td>
<td>0.0%</td>
<td>77.2%</td>
<td>0.6%</td>
<td>100.0%</td>
<td></td>
</tr>
</tbody>
</table>
As emphasised above the biggest investments will be in modernization of information technology which account for 77.2 % of total expenditures. Specifically those will be investments for development of the Module of e-invoice system for big taxpayers (with an estimated cost of 800,000 EUR), development of risk module by TAK (with an estimated cost of 350,000 EUR), IT modernization for taxes and customs (estimated about 10 million EUR) and Integration of IT systems in MF and subordinate agencies (estimated at about 3.9 million euro).

5.2 Sources of Strategy financing

It should be mentioned that although the estimated total cost for implementation of activities has been calculated for a medium-term period 2016-2018, 34.2% of the needs for financing will go beyond this period and continue even after 2018. However, this need relates to only two big IT investments, which, due to their nature, require a period of tendering, development and testing that goes beyond the three year period of the Action Plan of the Strategy 2016-1018 (see chart 3). This implies also a possible financial impact that goes beyond the period of MTEF 2016-2018 and therefore should be taken into account during the planning stage of MTEF 2017-2019.
Respective structures will plan the needs for budgetary financing through respective programs and budgetary lines, as part of the planning process of Medium-Term Expenditure Framework, and the annual budget, having in mind also the distribution of needs along the years.

Calculation of financing needs in the most optimal and correct manner, taking also into consideration the necessary tendering or recruitment procedures (in case of the needs foreseen for additional personnel), will help all structures involved in the strategy in order to be able to properly plan their budgets accordingly each year. This activity is expected to take place during the update which will be done on an annual basis, as well as midterm and final evaluations.

Chart 4: Sources of Financing of the PFM Strategy

As presented in Chart 4 above, the Government of Kosovo currently will finance 40.58% of the cost of the Strategy. Currently, 8 million EUR, funds needed to carry out activities, have been foreseen in Kosovo Budget. Meanwhile the second financial contributor remains the European Union that is currently directly contributing to financing of some activities through the IPA program, and in the coming years it will be the indirect contributor that will help the Government to implement the strategy through budgetary support foreseen to be given to the Government within the Program of Sectorial Budgetary Support (SBS) for Reforms in Public Finance Management. The Government shall also look into the possibility to, together with donor community, use other possible sources to finance activities resulting in financial gaps.

2 The table of measuring financial effects of activities foresees the financing needs in years not only in relation to activities but also at the level of product or sub-activity.
It should be stressed that the cost of strategy implementation is based on detailed assessment of needs for realization of the plan up to the level of product. But the real cost may easily pass to levels of financing calculated at this stage, since this would depend also on modalities of implementation of assistance by donors, which may be based in direct financing and sending experts to work in Kosovo institutions, or increase the assistance at the project level. In this case the real value of strategy implementation will increase. With the purpose of foreseeing implementation of activities according to the approach at project level, reserve costs have been foreseen for some activities (under heading “Other”).

Chapter 6 Reduction of Risk

The Strategy covers twelve priorities and a variety of activities for each priority. Every activity has its own challenges. In order to address these challenges, a risk assessment will be conducted for all priority objectives and activities in the framework of Indicator Passport that will be prepared following the adoption of Strategy (see Chapter 4).

Three main risks can be identified at the general level of the strategy. These risks and proposals for reduction measures for each of them are listed below:

<table>
<thead>
<tr>
<th>Risk</th>
<th>Measure to reduce the risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Commitment</td>
<td>This strategy is adopted formally by the Government and reflects political engagement for its implementation. In addition, implementation of PFM reform strategy is strongly incorporated into the structure for Public Administration Reform. This will ensure that delay in implementation will be signalled to the political leadership and timely political intervention is expected.</td>
</tr>
<tr>
<td>Financial limitations</td>
<td>The cost of implementation of this strategy is estimated to be 54.9 million, but this amount will definitely be higher based on the inability to estimate accurately activities in the field of IT or activities that are expected to be undertaken, such as cost benefit analyses, etc. This amount is not expected to be able to be allocated from the Kosovo budget. Therefore, full implementation of the strategy requires additional external funds. The EU has already indicated to be ready to agree on a Sector Budget Support Program (SBS II) to support implementation of PFM reform strategy. In case sector budget support will be achieved, the main risk would remain implementation of requirements deriving from the agreement. In case agreement is not reached or PFM program of sector budget support is delayed, the midterm budget review in 2018 should lower the ambitions of this strategy.</td>
</tr>
<tr>
<td>Lack of technical expertise</td>
<td>Some of the PFM reforms would require international expertise to guide activities in Kosovo. Such international expertise is regulated in a more effective way by international development partners of Kosovo. In addition to IPA assistance with Technical Assistance projects, outside sector budget support (SBS), as facilitation measure we propose organisation of a meeting in mid year with partners who are interested to support the PFM strategy to discuss about the progress. In these meetings we would discuss problems in the area of technical expertise with our development partners.</td>
</tr>
</tbody>
</table>