SIGMA

Support for Improvement in Governance and Management

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ASSESSMENT

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PUBLIC EXPENDITURE MANAGEMENT AND CONTROL

[1] In accordance with UN Security Council Resolution 1244/99, since June 1999 Kosovo has been governed by the UN Interim Administration Mission in Kosovo (UNMIK).

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Main Developments since Last Assessment

Some activities were developed in the area of ***public expenditure management*** (PEM) to address the main weaknesses of the system. A Public Expenditure and Financial Accountability (PEFA) assessment was finalised by the Ministry of Economy and Finance (MEF) with the support of the World Bank in May 2009 Based on the findings of the assessment, the MEF has developed an Action Plan on Public Financial Management Reform, using the platform (or phases of reform) approach. The Action Plan was approved by the Government in November 2009. It does not contain a clear timeline but most of the sub-areas span over 2010 and 2011. It seems that by initiating this action plan, the MEF has taken ownership of the financial management reforms. This would be an important step in the right direction.

A Strategic Planning Office was established within the Prime Minister's Office. It is responsible for identifying government priorities and linking strategic policy with the budget planning. The Agency for Coordination of Development and EU integration has been transformed into a ministry that will also be responsible for donor coordination.

A draft Law on Public Debt is currently going through the Kosovo Assembly's approval procedure. The law will regulate the authority and procedures for borrowing, debt management, and guarantees for central and local governments.

The Management Information System is now also being used by the municipalities. Responsibility for feeding the system with the necessary information lies within each municipality. Ignoring the system is sanctioned by budget restrictions.

The new Law on Civil Service and the Law on Salaries were adopted in May and will soon come into force. An attempt to address the issue of low salaries and brain drain from the public administration has been made through the so called "Brain Fund" established by the Government in 2009 and financed out of the national budget. It aims to financially support particular positions within the civil service. The positions covered are mainly those that deal with strategic planning, policymaking, EU integration, budget planning, etc. To date, 115 positions have been approved under this fund, 33 of which are reserved for the MEF. 30 more are expected to be approved. Around 40% of these positions are vacant and will be filled after an open competition.

With regard to ***public internal financial control*** (PIFC), a CHU for FMC was recently established under the responsibility of the Treasury in accordance with its 2009 strategy. During 2009, the Department of Treasury and the CHU/IA organised training in KFMIS for all internal auditors. The Treasury has developed a workplan 2010-2013 for further developing administrative instructions on FMC, organising training to increase capacity and awareness, and preparing procedures.

The new Law on Internal Audit (Law No. 03/L-128) was approved by the Assembly in September 2009 and promulgated by the President in October 2009. Under this law, the MEF has adopted administrative instructions that set out criteria and procedures for the temporary licensing of the internal auditors already holding a position in the CHU or an Internal Audit unit when the new law came into effect. The instructions also regulate the establishment and operation of Internal Audit Units in the public sector. An administrative instruction on the functioning of the Audit Committees is currently being developed. The CHU/IA has developed a system of reporting, with quarterly and annual reports required from budget organisations. The system also requires that the CHU provides similar reports to the Ministry of Finance and Economy, who them on to government.

Regarding ***External Audit,*** a Corporate Development Strategy (CDS), a Regularity Audit Manual, a Quality Management Framework and a Performance Audit Guideline have been developed and adopted by the Office of the Auditor General (OAG) during 2009 as a first platform for development. The number of mandatory audits increased to 120 in 2009, due to a rise in the number of state public authorities and other budget-users. In 2009, the OAG carried out 26 audits with its own resources, while 31 audits were contracted out to private audit firms. In total, these 57 audits represented 80% of total expenditure and 95% of total revenue. A comprehensive OAG annual audit report (2009) was produced on time for the first time and was submitted to the Assembly at the end of August. A positive development was the establishment at the end of 2009 of a new Parliamentary Committee

on Oversight of Public Finances (COPF) which will have all OAG issues under its responsibility. The COPF has started carrying out public hearings based on reports from the OAG and other institutions.

In 2009 mid-year budget review, the OAG requested funds covering an additional 16 staff. Another 10 posts were approved in the 2010 budget. This means the OAG now has 116 staff, up from 85 a year earlier. 89 are audit staff and 27 support staff. First steps were taken for developing a new improved certification programme for all OAG auditors.

At the end of April 2010, the OAG published its second Performance Report. The first one, published in 2008, paved the way for better budget dialogue between the OAG and the Assembly.

Main Characteristics

The legislation for ***Public Expenditure Management*** is in place and contains many elements required by international standards and practices. However, in some areas, discrepancies between the legislation and its implementation remain. The financial management and information system is well established but administrative capacity, especially for analysing data, is weak. As a result, these systems are not yet fully used. Strategic planning and policymaking is weak, as are capacities and understanding of the importance to change the situation. The same can be said of the link between existing strategic planning/policy making and budget planning. Coordination between strategic policy, state budget planning and donor assistance is still not successful. Civil service salaries and incentives to retain highly qualified staff are low, leading to high turnover and severe damage to the sustainability of reforms. Furthermore, permanent-secretaries, who are the main managers, are frequently changed.

PIFC is still at an early stage of development. The general understanding of the concept but also ownership within the CHUs needs to be further developed. This will take considerable time, both in FMC and IA. The legal basis has been developed and is increasingly harmonised with EC requirements**,** but the levels of understanding of the technical concepts and requirements and of the standards of application generally appear to be limited. For FMC, the focus is still on the secure and efficient management of the KFMIS. It can be noted that the Treasury has started releasing its current ex-ante control and that management responsibility is being devolved to budget organisations. While this is, in general, a welcome development, it requires that the competency for exercising the necessary controls in those budget organisations can be guaranteed.

Data show an increase in the number of internal auditors, Audit Units and Audit Committees. The number of established IAUs has risen to 59, and the total number of internal auditors i is now 97 at the central level and 35 at the municipal level. The number of Audit Committees has increased to 31. Most of the internal audit units report that they have developed strategic plans and annual audit plans. The CHU's annual report mentions 360 completed audits (300 in 2008) and 2,207 issued recommendations (1,900 in 2008), of which a majority are reported to have been implemented or in the process of being implemented. However, no information on the quality of audits, reports and recommendations is available.

There is a risk that efforts will focus on more advanced concepts (such as risk management or audit committees) and draw attention away from basic requirements, such as compliance with rules and clear segregation of duties, or basic audit skills.

In the area of ***External Audit***, audits have increased both in quantity and quality. Reports are now made available on time and have improved in quality with regard to readability, clarity, and alignment with International Auditing Standards. The number of staff positions approved for the OAG and its budget have increased significantly in comparison to last year. The focus in training has switched from theoretical to practical on-the-job training (coaching) and audit staff have acquired an increased understanding and knowledge of audit practice according to international standards. Regarding the OAG's increasing professional capacity, the impact of its work is limited by insufficient attention given to its findings by auditees and Parliament. The OAG does not have the capacity to audit annually the increasing number of mandatory audits. As long as Kosovo is not a member of the UN, the OAG will not be able to become a member of INTOSAI and EUROSAI.

Reform Capacity

The generally low administrative capacity, a high turnover of the most qualified staff and a lack of ownership of reform initiatives are still impeding future developments in all areas of ***Public Expenditure Management, PIFC and External Audit.*** The "Brain Fund" is an interesting initiative but it will not be seen as providing a substitute for the development of a sustainable civil service system with appropriate salaries and incentives to attract and retain qualified staff for key positions. The approval of the new Law on Civil Service is an important step in this regard. The Public Financial Management Reform Action Plan is an attempt to set up a comprehensive reform agenda, and it also covers PIFC and external audit. It paves the way for further improvement and might also facilitate the co-ordination of the various reforms in a meaningful manner within the context of overall public expenditure management. Its success will largely depend on the development of ownership by Kosovo's authorities of the different reform initiatives. However, managing and monitoring this comprehensive plan risks confiscating the resources needed for the implementation of its elements.

Kosovo's Ministry of Finance and Economy has demonstrated its willingness to continue developing the ***PIFC*** system. This can be seen in the establishment of the CHU/FMC, the increase in the CHU/IA's capacities, the establishment of Internal Audit Units and Audit Committees, and the development of their strategic plans, and an the increased co-operation between the central level and budget organisations. EC funded technical assistance project is important for the further development of the IA system. The current project's proposals that deal with public expenditure management and PIFC should provide a strong incentive for improvement, ensuring a logical sequencing that focuses on basic requirements rather than advanced arrangements.

With the timely delivery of the annual report on the audit of the KCB and the two performance reports for 2009 and 2010 (both published at the end of April), the OAG has clearly shown its dedication to respecting the obligations under the Law on OAG and to the further development of ***External Audit***. With its second Annual Performance Report, the OAG has shown its ability to critically analyse its performance and to identify areas with room for improvement. An EC twinning project with the UK's National Audit Office and peers form the Netherlands and Slovenia started in 2009 to mentor and coach the OAG in the implementation of important parts of the Corporate Development Strategy. The Strategy contains a "step by step" approach for establishing a Kosovo National Audit Office that carries out its mandate in a sustainable way in accordance with internationally recognised auditing standards and good European practices, and that is fully managed by Kosovans. In 2009, the first "platform" (phase of reform) of this approach was established. Improving the relationship with Parliament in order to improve the impact of audit reports is also part of the strategy. The OAG will need substantial external assistance for still some time, but it has proved its capacity to reap maximum benefit of the assistance it receives.