



**SIGMA**

**Support for Improvement in Governance and Management**

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**KOSOVO (under UNSCR 1244/99)<sup>1</sup>**

**PUBLIC EXPENDITURE  
MANAGEMENT SYSTEM**

**ASSESSMENT MAY 2009**

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

## 1. Summary

### *Main Developments since last year*

In general no fundamental changes have been made since last year, although some developments have certainly taken place. The approval of the new Law on Financial Management and Accountability (LFMA), including the regulation of the Medium-Term Expenditure Framework (MTEF) preparation and approval process, as well as the additional efforts made in terms of donor co-ordination (creation of a new agency responsible for all donor co-ordination) and investment planning are certainly worth highlighting. One has to keep in mind, however, that the implementation of these initiatives and their eventual merits cannot be addressed yet.

### *Main Characteristics (strengths and weaknesses)*

- The legal framework established for public expenditure management in Kosovo contains many elements corresponding to international standards, mainly due to the efforts of the international community. However, the gap between some of the legal requirements and the current administrative capacities seems to be too large to be bridged.
- One of the most important issues affecting reforms in this area is the lack of effective donor co-ordination, which results in an ineffective use of most of the resources provided.
- Development activities in public expenditure management are not logically integrated, and there is no coherent and overall strategy for the development of financial management. Some departments in the Ministry of Finance and Economy (MFE) prepare annual work plans, which include development activities foreseen for the following year, but there are basically no consultation mechanisms set up between departments for the preparation of these plans (sometimes one department was not even aware that another department had a work plan).
- Strategic planning is in its very early stages, thereby limiting the further development of the MTEF.
- The IT systems supporting various steps in public expenditure management are well developed. However, due to the lack of administrative capacity, these systems are not used to the fullest, since the capacity to analyse data in both the budget preparation phase and the execution phase is lacking.

### *Recommendations for Reform*

- National administrations should take stronger ownership of reforms, co-operation mechanisms within the administration should be strengthened, and attempts should be made to co-ordinate the various reforms in a meaningful manner within the context of overall public expenditure management. It would be worthwhile to develop a comprehensive reform agenda (covering the entire public expenditure management cycle). It would be rational to lower ambitions with regard to more sophisticated developments (such as programme-based or results-oriented budgeting or a performance system in local health care); resources should be devoted to getting the basics right first before moving on to further developments.
- It would be worthwhile to carry out an analysis of current legislative acts in the area of public financial management, with the aim of providing an overview of
  - a) regulations that the administration is currently unable to implement and the implementation of which it would be rational to postpone, and
  - b) the functions that are currently exercised but are lacking a legal base. This kind of knowledge would help to diminish the current gap between legislation and actual capacities and reduce the loopholes in the legislation. Each legislative act should have an “owner” in the administration.

- c) regulations that are incompatible with the overall set-up of laws and institutions and which lead to a lack of real accountability and of real enforcement mechanisms.
- Steps should be taken to achieve the harmonisation of (planning) processes of external and internal funds, create better systems for donor co-ordination, and enhance budget coverage in relation to donor funds.
- The overall analytical capacity for each and every step of the public financial management process should be enhanced substantially. In this regard, additional training is not enough. The problem most probably lies in the motivation and good will of officials in trying to understand the substance of the processes they are responsible for as well as their willingness to develop themselves and the systems and procedures in the areas of their responsibility.

## 2. Legal Framework

Overall principles for public financial management are established by the new Constitution, which states that public expenditure and the collection of public revenue are to be based on the principles of accountability, effectiveness, efficiency and transparency; that the conduct of fiscal policy at all levels of government is to be compatible with the conditions for low-inflationary and sustainable economic growth and employment creation; and that public borrowing is to be regulated by law and to be compatible with economic stability and fiscal sustainability.

Fiscal matters in Kosovo are mainly regulated by the Law on Financial Management and Accountability (LFMA), Law No. 03/L-048, which governs budget planning and execution, reporting, accounting, auditing and financial control, and defines the officials and institutions involved in public financial management. All provisions of the law also apply to municipalities to the same extent as to any other budget organisation, if not specifically provided otherwise by a provision of the LFMA or by the Law on Local Government Finances (LLGF), Law No 03/L-048). The Internal Audit Law (Law No. 02/L-74), which was published in June 2007, is applicable to all public sector entities, including each and every public authority and public undertaking in Kosovo.

The preparation of the annual budget is regulated in more detail by budget circulars issued annually by the Minister of Finance and Economy. Separate circulars are sent to budget organisations and municipalities. The initial circular provides instructions, a tentative timetable and ceilings for the preparation of the budget proposals; if needed, the first circular is followed by additional circulars during the budget preparation process. The Kosovo Consolidated Budget (including also the budget for municipalities) is passed by the Assembly annually. For budget execution Treasury regulations give more detailed provisions.

The new LFMA, passed in 2008, replaces the LFMA of 2003. One element of the new LFMA which was the regulation of the Medium-Term Expenditure Framework (MTEF) process, which previously occurred without a proper legal base. Other amendments include specifications regarding deadlines within the budget planning process and amendments of the budget and regulations in the event that unexpected activities need to be financed or that changes in the structures of budget organisations and municipalities are made during the budget year.

The annual budget has also gone through some changes, mainly regarding additional provisions with respect to personnel expenditures (the government does not have the right to increase the number of employees in the public service – the Assembly has the relevant prerogative right) and the use of the capital budget (during the budgetary year, less flexible possibilities to make changes in the planned investment envelope).

In overall terms the legislative framework is very strict and detailed, including for municipalities, which leaves municipalities basically no room for independent decision-making (for example, the budget circulars give very itemized instructions for the internal budget preparation process within the municipality as well as setting strict budget and staffing ceilings).

In the past year improvements have been made regarding the comprehensiveness of the legislation (e.g. regarding MTEF, which was mentioned above). However, there is still a need for further improvement, as some matters have remained legally unregulated. For example, according to the MTEF the government has made a decision to create a stabilisation reserve, although the LFMA does not stipulate the creation and use of any kind of fiscal reserves. The issues regarding the possible creation of fiscal reserves and the terms and conditions for using such reserves should be regulated by the LFMA.

In general, the legislative framework contains many elements of good practice and international standards, but in many areas there are aspects that are much too advanced. Those regulations are ahead of the current real state of development, and therefore in many aspects the legislative framework is not understandable to the officials implementing the acts or to the public in general. The main problem therefore lies in implementation, mainly due to the lack of relevant administrative capacity and to the poor understanding of legislative acts (the need for some provisions is not

understood). One of the reasons for such a situation is most probably the lack of ownership. Currently not all of the legislative acts are “owned” by a specific department within the administration – for example, the LFMA was amended without the proper involvement of the related departments. A clear division of responsibilities within the administration should be made in order to ensure the implementation of legislative acts as well as the realisation of future developments. This issue has already been addressed in previous assessment reports, and the situation can also be foreseen to last for the coming years.

It is clear that the international community has not sufficiently co-ordinated its efforts to ensure a coherent style throughout the Kosovan legal framework so as to make it comprehensive, consistent and transparent. Despite all of the previous problems, the legal tradition in Kosovo was based on continental European law; there is now a certain mixture of continental and common law institutions (commissions/agencies, etc.). This situation has – for certain institutions – resulted in a lack of real accountability and of real enforcement mechanisms due to the incompatibility between the different legal systems. It could lead to the subjective interpretation of legislation, while leaving other necessary parts of the legal framework unregulated.

**The legal framework established in Kosovo for public expenditure management corresponds to international standards as a result of the efforts of foreign experts, although it contains some inconsistencies and some matters have remained unregulated. The main problem, however, lies in its implementation, mainly due to the lack of relevant administrative capacity and a poor understanding of the rule of law. Furthermore, it can still be said that in many areas the laws are ahead of the current real state of development, and therefore in many respects the legislative framework is not understandable to the officials implementing the acts or to the public in general.**

### 3. Institutional Framework

The Constitution lays down the overall division of fiscal authority between the legislature and the executive, stating that the government proposes the budget of the Republic of Kosovo and that the Assembly approves the budget. In the Assembly the Committee on Budget and Finance, composed of 12 members, is responsible, according to the rules of procedures, for fiscal issues. The main tasks of the committee include:

- discussing budget and finance matters, including the annual budget;
- control of annual reports and financial oversight of the Consolidated Fund of Kosovo associated to the budget;
- setting the possible expenses that can be allocated by each draft law and making recommendations in the relevant functional committee of the Assembly, when appropriate.

The deadlines for the government’s submission of the budget proposal and other related issues are prescribed by the LFMA. The LFMA also provides very detailed responsibilities for specific departments (namely Treasury and Budget Department) of the Ministry of Finance and Economy (MFE) and for specific officials in the administration.

The MFE came into being following the abolition of the Central Fiscal Authority (CFA) at the end of 2002. The MFE (including the tax administration) has 888 employees in 2009, in comparison with 871 in 2007. The main departments of the MFE responsible for public financial management are the Budget Department, the Department of Local Municipalities, and the Treasury. A separate unit in the MFE has been designated to deal with public investments.

The responsibilities of the Budget Department, according to the LFMA, include the following: developing a proposed Kosovo Consolidated Budget, preparing the Medium-Term Expenditure Framework, implementing the Kosovo Consolidated Budget, and assessing requests for changes to appropriations. The head of the Budget Department is supervised by the Secretary General of the MFE.

According to the legislation there is to be one Budget Department with two separate units under it: a central budget unit and a municipal budget unit. In 2007 the MFE upgraded the municipal budget unit to a department, with the effect that there are now two separate departments – one dealing with central budget issues and the other with municipal budget issues. It should not be concluded, however, that there is a contradiction with the LFMA, as the law states: “The Minister shall have the authority to establish other departments or units within the Ministry, and to reassign responsibilities among the departments and units of the Ministry, as may be reasonably necessary to assist the Ministry in fulfilling its functions and responsibilities under the present law or another law.” The conclusion can nevertheless be drawn that the law is excessively detailed and prescriptive.

As the Budget Department is responsible, according to the LFMA, for the preparation of the budget, and the budget of municipalities is a part of the Kosovo Consolidated Budget, a very clear division of duties and responsibilities between the two departments should be ensured.

The Treasury is responsible for managing the Kosovo Consolidated Fund. The LFMA in a way emphasises the Treasury’s independence, stipulating that the Treasury is to operate with substantial autonomy and be responsible for its own organisation and staffing, including the hiring of its own financial officers. The general director of the Treasury serves a five-year term. The current structure of the MEF places the Treasury directly under the Minister of Finance and Economy.

Donor co-ordination is the responsibility of the Agency for Co-ordination of Development and EU Integration, an agency under the Prime Minister. The functions of the agency were recently enhanced – previously the responsibilities covered EU relations only. The agency is expected to provide an overview of all of the aid received (including all of the projects financed in the various sectors); however, the agency has not yet provided the overview and the division of responsibilities and co-operation with the MFE is therefore not yet in place. In June 2007 a discussion note on aid management in Kosovo was issued. This note indicated clearly the shortcomings in aid management in Kosovo, both between the Kosovan authorities and the donors and between the donors. The creation of a separate agency for donor co-ordination, which may be in the interest of donors, creates the following risks for the Kosovan financial management system:

- lack of co-ordination with the national budget;
- weakened position of the MFE, given the volume of donor funds;
- distortion of political responsibilities.

It should be considered to give more responsibilities for donor funding to the MFE or to move the function entirely to the MFE as it alone has an entire overview of state finances and is able to assess the impacts of foreign aid channeled to the various sectors.

The senior management and staff of the MFE are largely Kosovan, although the number of foreign experts remains relatively high. A high proportion of MFE staff exercises support functions. A project to assess the functions within the administration is underway, which should provide support for optimising the structures of the ministry.

**In conclusion, it must be pointed out that currently co-ordination mechanisms between the various structures within the administration are not properly in place and responsibilities have not been clearly set.**

### ***3.1 The Scope and Transparency of the Budget and Quality of Budget Documentation***

The Kosovo Consolidated Budget is very detailed, setting limitations for each institution by department; the budget allocated to each department is divided into programmes, each of which is structured according to the economic classification of expenditures. The investment envelope itemises investments, including even the purchase of telephones. Together with the annual budget, the number of employees for each department within an institution is also set, leaving basically no room for making necessary management decisions during the year (e.g. moving an employee from one department to another within a ministry).

Even though the budget has programmatic classification, the actual capacity to perform programme budgeting is almost non-existent. Furthermore, the basic understanding of a programme does not seem to be in place, as programmes are named and determined according to department (for approximately 90% of budget lines there is no difference between a programme and a department). Such an exercise does not contribute to budget transparency and further increases the administrative burden.

According to article 2 of the Law on Financial Management and Accountability – LFMA (which specifies what constitutes public money and indicates the sources of public revenue), one source of revenue is represented by grants and gifts from international organisations and foreign governments, which in fact is not planned in the annual budget. The fact that donor funds are not included in the annual budget decreases the transparency of public expenditure management and does not create favourable conditions for well-advised budgetary decision-making in Kosovo, even though approximately 10% of donor funding flows through the Treasury in budget execution.

More importantly, it is an issue of whether donor funds will be rationally allocated and spent and whether relevant guaranteed national co-financing will take into account financial limitations within the budget framework. The related risks are also increased due to the fact that the lines of responsibility between the various institutions involved in monitoring and co-ordinating foreign aid are not clearly set (as also indicated above). Aid in Kosovo has relatively low government ownership and is generally not well co-ordinated. It is characterised by unmanaged allocations between sectors, relatively high allocations for technical assistance (consultants and advisors), and low allocations for capital investment. Almost all aid is in the form of projects, which do not rely on government procedures and public financial management systems and are not reflected in government budgets.

**Even though annual budget expenditures are planned and tightly controlled at a very detailed level, the budget scope is not comprehensive, and some revenues and expenditures are left out of the process.**

### **3.2 The Planning Process**

The planning process includes a medium-term focus (with top-down elements), in addition to the annual budget preparation process, but currently the planning of activities and the planning of finances do not interlink properly. The various documents produced within the planning process contain many elements which are required by international standards, but sometimes no consultation and/or negotiation process is behind the approval of these documents. Furthermore, they do not necessarily reflect the reality in the country, and sometimes those responsible for implementing them are not even aware of their existence. In addition, the government does not take responsibility and action in accordance with the approved documents.

#### **3.2.1 Medium-Term Expenditure Framework**

A Medium-Term Expenditure Framework (MTEF) was approved by the government for the first time in December 2005. This document, covering the period 2006-2008, provided an overview of recent fiscal trends, forecasted the macroeconomic outlook up to the year 2008, and included budget deficit, revenue and expenditure projections. The MTEF 2008-2010 was issued on 17 September 2007, and the MTEF covering the period 2009-2011 dates from 12 June 2008.

As indicated above, the preparation of the MTEF was regulated in 2008. The LFMA now sets the deadline (30 April each year) for the submission of the MTEF to the Assembly and also sets the requirements for the content of the document. The MTEF covers the next fiscal year and estimates for the two following fiscal years. It contains macroeconomic and fiscal forecasts, an analysis of tendencies in the allocation of financial resources, an analysis of budget expenditures by main economic category, an analysis of capital investment tendencies, and a review of salary policy and other financial information. Information on strategic targets and goals that have been set or any other kind of performance information is not obligatory.

Despite the above, there is no systematic strategic planning system in place, and various strategic documents (for both overall strategies and sectoral or line ministry strategies) do not form a

systematic base for budgetary allocation. Furthermore, the budget department currently does not have the responsibility to assess the budgetary impacts of various strategies, which will most probably lead to a situation where many of the approved strategies will never be implemented due to a lack of budgetary resources. In view of this situation, it is hardly possible to rationally plan a budget in the medium term as there is no overall strategic planning system in place that is linked to budgetary decision-making processes. In the context of the MTEF and programme budgeting, it is not possible to plan a budget for a longer period than that of the planned activities using those funds.

**There are no proper consultation and/or negotiation processes behind the approved documents for the Medium-Term Expenditure Framework (MTEF). Furthermore, the government does not take entire responsibility and act in accordance with the approved MTEF. The value-added currently gained from the MTEF is therefore rather questionable.**

### 3.2.2 Annual Budget Process

The annual budget preparation process starts in April when, according to the Law on Financial Management and Accounting (LFMA), the first budget circular is issued. The initial budget circular provides instructions and requirements as well as a tentative timetable for the budget preparation process. According to the LFMA, the date by which municipalities must complete and submit their proposed budgets and appropriation requests is 30 September. For other budget organisations, the deadline for submitting such documents – and also for all other steps in between the initial and final deadlines determined by the law regarding the budget preparation process – are specified annually in the budget circular. In October the final decision on the draft budget is taken by the government. Although the budget preparation process starts early, there is limited time for discussions at parliamentary level as the budget is not submitted to the Assembly before 30 October.

However, it should be noted that the current budget calendar has not yet been followed in practice (the new LFMA came into force in 2008); furthermore, the budget preparation calendar that was initially set has not in the past been entirely followed. In 2008 the MTEF was approved only on 12 June, which caused a delay in the issuing of the first budget circular, which gave budget organisations 17 days to prepare and submit their budget proposals. The Kosovo Consolidated Budget for the year 2008 was only approved on 29 February 2008 due to the November 2007 Kosovo-wide elections and the formation of the new government. Therefore, on 31 December 2007, by means of an administrative direction, the fiscal year 2007 was extended by two months until 29 February 2008.

Although the LFMA in general is rather detailed and sets very explicit requirements for the content of a budget proposal, it does not specify rules and regulations for the budget preparation process. The law gives considerable freedom to the Minister of Finance and Economy in the budget process as it does not determine the roles and responsibilities of the MFE (e.g. there is no requirement for budget negotiations being held nor any requirements for the MFE to assess budget proposals). Furthermore, no comprehensive methodology has been worked out for preparing and assessing budget proposals as well as evaluating the budgetary impacts of legal acts and strategic documents (such an assessment is needed even more now that the number of budget-users and the amount of the annual budget have increased). The focus in reviewing budget proposals is on determining whether various requirements (mainly stemming from the budget circulars) have been fulfilled. The obligation to assess the budgetary impacts of all new pieces of legislation has been set, but this rule is not always followed and does not apply to strategic documents at all.

The law does not regulate the budget process in the Assembly – it is only stated that the Minister of Finance has the right to receive adequate notice of, and participate in, any hearing held by an Assembly committee regarding any aspect of the proposed Kosovo Consolidated Budget or the proposed Appropriations Law.

**In overall terms, the capacity to both prepare budget proposals and analyse these proposals is weak. Furthermore, proper impact analysis of new pieces of legislation or of amendments to existing legislation is lacking; also the strategies are prepared without any proper financial impact analysis. This situation creates a risk that, once the legal act has been adopted,**

**additional needs for financing will emerge and cannot be implemented since they had not been planned for in the budget.**

### 3.2.3 Public Investments

According to the LFMA, within the preparation process for the MTEF an analysis should be made of capital investment tendencies financed from the budget as well as an assessment of their volume for the next budget year and the two following years. The budget prepared by the Minister of Finance and Economy has to include a capital programme, setting forth a multi-year capital investment plan that identifies and includes the highest priority needs and proposed capital projects for the upcoming fiscal year, together with estimates of the financial impact of such projects on future years.

Within the 2009 budget preparation process, budget organisations were required to develop and submit their financial proposals for public investment projects based on the strategies that emerged from the priorities set by the Government of Kosovo. Although the requirements for the investment budget proposals are said to have been developed, the budget circular in general gives very few instructions, if any, regarding the planning of investment. As the latest circular does not require any analysis of the investment proposals to be presented to the MFE, it remains unclear how the MFE is able to use the information received through the budget preparation process. In addition, no principles have been set down for the analysis and selection of investments to be financed.

One of the main problems faced in this area has been a very low level of execution of the investment budget (70% in 2006 and in 2007), which also indicates that the planning process has to be reviewed and considerably strengthened.

There is a plan to create a separate body within the MFE that would be responsible for public investment planning. The positive impact of such a structural change would hopefully be a sharper focus on improving the current system. However, such a change would also mean that the procedures for preparing and approving budget proposals for capital expenditures would probably not be fully integrated with those for recurrent expenditure, which in a long-term perspective could be seen as an obstacle to further developments in the area of public expenditure management.

**Investment planning capacities are at this stage rather weak, and the fact that viable processes and procedures are not in place does not help. Investment planning processes (also at municipal level) are not properly linked to the entire planning process, including strategic planning initiatives.**

### 3.2.4 Municipal Budgets

According to the LFMA, municipalities should receive Operating Grants, which are divided into a General Grant, a Specific Grant for Education and a Specific Grant for Health. The amount of the General Grant is to be the equivalent of 10% of budgeted central government total revenues, excluding revenues from the sale of assets, other extraordinary revenue, dedicated revenue and proceeds from borrowing. In the future and in the event that donor grants are included in the budget (which could cause remarkable annual changes in the volume of revenues), this provision will most probably not be justified and it will be extremely problematic to implement.

To compensate for the low own-source revenue capacity of smaller municipalities, from the total of the General Grant each municipality is to receive a lump sum of 140,000 EUR per year less 1 EUR for each member of the population or 0 EUR for municipalities with populations equal to or greater than 140,000. The remainder of the General Grant is to be allocated between municipalities in proportion to the size of the total population, the size of the minority population (and in addition if a majority of the population is composed of a national minority or minorities), and the geographical area. Population is to be weighted at 89%, size of the minority population at 3%, municipalities with a majority of the population composed of national minorities at 2%, and the geographical area at 6%. Therefore, according to the Law on Local Government Finance (LLGF), when preparing a budget the Minister of Economy and Finance is obliged to use the above formula when proposing the amounts to

be appropriated for municipalities. However, it has to be pointed out that in practice the formula does not work properly, mainly due to the fact that updated reliable population statistics are not available.

In 2009 the Specific Grant for Health included a new financing mechanism that aims to stimulate the performance of health providers and encourage improvements in the quality, effectiveness and efficiency of health care services. The performance-based payment would be 5% of the total health grant for each municipality. At the time that the system was initiated by the budget circular, the actual implementation of the performance financing system (including the determination of performance targets and measures) had not yet occurred.

The process of the municipal budget preparation and the use of the funds available are regulated in great detail by the central government, as the Minister of Finance and Economy issues a circular for municipalities that sets very detailed requirements. Staffing and wage ceilings as well as performance salary components in health care for each municipality are also set out in the circular. These ceilings are set despite the fact that the LLGF stipulates that municipalities are entitled to receive a General Grant, which they may use in the discharge of any of their municipal competences in accordance with the applicable laws of Kosovo. The steps in the budget preparation process are also determined in a very detailed manner; for example, it is indicated in the MFE circular when and how many internal budget circulars a municipality may issue. Therefore, although the budget preparation process in practice may actually happen as indicated in the circular, municipalities have very little room to make their own management decisions.

**In general the financing of local municipalities currently does not work properly, but the issues behind the current situation extend way beyond the problems arising from the financing regulations. Until the borderlines of municipalities' rights and responsibilities in practice have been drawn, it is probably not worthwhile making efforts to promote very sophisticated developments, such as performance financing in the health care system. The basics and the basis for any developments, such as general principles for municipal financing in line with the rights and responsibilities of municipalities and relevant control mechanisms, should be put in place first.**

### **3.3 Budget Execution and Monitoring**

Budget execution in Kosovo has been fairly low, mainly due to the limited use of funds foreseen for capital expenditures – approximately 30% of these funds were not used during the budget years 2006 and 2007. As it was not permitted to carry any unused funds over to the next budget year (except for appropriations relating to any unspent own source revenues of a municipality), there is a potential incentive to undertake inefficient spending (with respect to all expenditures, not only investments) towards the end of the year. In addition, this situation necessitates the estimation of funds that will be needed for an investment project that is being implemented but will not be completed by the end of one year, and entering those figures into the budget for the following year.

The reasons for capital budget underspending do not stem from the existing legal and regulatory framework for public investment management and public procurement. Capacities to implement the specified procedures are limited and affect the planning, management and implementation of capital spending programmes. Other factors that contribute to capital budget underspending are the single-year outlook in public investment management, including the operation of the Public Investment Programme (PIP) procedures, the budgeting of the capital spending programme, and the operation of public procurement procedures. In the recent MTEF, steps have been foreseen to improve budget execution figures; the possible results of those actions will be seen in the future.

During the budgetary year the Minister of Finance and Economy may reduce the level of funds allocated in respect of an appropriation that was authorised under an Appropriations Law if such a reduction has been made necessary by a macroeconomic shock resulting in reduced revenue, a natural disaster, or the suspension or cancellation by the government of the programme or project to which the allocation relates, and if the minister has received a written authorisation from the government approving the proposed reduction. If an event occurs that requires an urgent or unforeseen

expenditure, a budget organisation may apply to the minister for additional funds to cover such an expenditures (this is one of the recent changes made to the LFMA).

The rules for changing appropriations are as follows:

- without obtaining the approval of the Minister of Finance and Economy, a budget organisation may transfer up to 5% of one of its appropriations to another of its appropriations during any fiscal year, provided that no such transfer is made to wages and salaries;
- the Minister of Finance and Economy may authorise the transfer between appropriations of up to 15% of the negatively affected appropriation;
- the government may change up to 25% of the negatively affected appropriation;
- further amendments to appropriations required the approval of the Assembly.

The possibilities of shifting funds between appropriations are therefore rather wide, which means that in principle there is no need for either a rational explanation or for the Assembly to actually approve the budget at such a detailed level. To increase transparency, it might be worthwhile to consider the creation of a system whereby the Assembly would approve a budget that is less detailed and the government would have the obligation of approving a more detailed budget.

The Treasury within the MFE is responsible for the performance of ex ante control of all payment orders. The Treasury is also responsible for the maintenance of financial software. The FreeBalance accounting system, which was installed with USAID assistance in the MFE and in all budget organisations, is currently operational.

All public money is to be deposited in an official bank account that has been established or designated by the Treasury. However, financial assistance to a municipality from the Republic of Serbia may be deposited in a commercial bank account, as provided for in the LLGF.

**Although the annual budget is approved at a very detailed level by parliament, the possibilities for the government to shift funds between budget lines during the year without parliamentary approval are rather wide. To increase transparency and effectiveness, it would be worthwhile to consider amending the current budget system by setting up a multi-level decision-making process. With regard to expenditure control, once internal control arrangements within budget organisations supported by internal audit have developed, it would be rational to loosen some of the controls that the Treasury is currently exercising.**

### **3.4 Accounting and Reporting**

According to the LFMA the chart of accounts must be consistent with the IMF General Finance Statistics (GFS). The budget classification system may be modified to meet the specific information needs of the government. Each budget organisation is obliged within 30 days of the conclusion of each fiscal year to provide to the General Director of the Treasury the unaudited financial statements and a confirmation in writing that such financial statements give a true and fair presentation of the finances and financial transactions of the budget organisation. Within 90 days the Treasury should reconcile the financial statements received and provide the financial statements for all budget organisations to the Auditor-General for auditing.

Within one month of receipt by the budget organisation of its audited financial statements, each budget organisation must submit to the MFE an annual report for the previous fiscal year. The MFE presents a consolidated report on each budget organisation to the Assembly and to the government within 30 days of receipt of the budget organisation's report. In addition, no later than 31 March of each calendar year, the Minister of Finance and Economy is to prepare and submit to the government for approval and submission to the Assembly a final budget reconciliation report on the budget for the previous fiscal year and the two prior fiscal years.

Information on budget execution is produced monthly, quarterly and annually, but these reports are not used as inputs to the budget preparation process; one of the main incentives for producing the

reports is to comply with relevant international standards and good practices. The same situation applies to audit reports, which are produced but not used, and accordingly no decisions within the budgeting process take audit findings into account.

**In general, various reports (including audit reports) are not systematically used as an input to budgetary decision-making. Accounting and reporting systems as well as timing of the reports currently do not meet the needs of the planning process.**

#### **4. Capacity to Further Develop the System**

The main weakness limiting future developments in public expenditure management is the lack of ownership – for example, no department in the administration takes responsibility for fundamentally important legal acts, such as the LFMA. This situation seems to be derived from the fact that many of the developments initiated by international experts, even while induced by actual local demands or needs, have not been taken over by the Kosovan authorities; furthermore, these developments are not logically sequenced and do not form a systematic entirety (no effective donor co-ordination is in place). As a result, the reforms that have been carried out are not understandable to local officials and therefore these officials are not able to implement them.

Another issue hampering further developments in this area is the generally low administrative capacity, which is very much linked to the low salary levels (and at the same time the rather unbalanced workload of officials), low motivation and high rate of staff leaving the civil service. The last issue is especially true regarding young and relatively well-trained officials, who leave the administration for higher salaries offered by donors or international organisations. Using the budget as a tool, it would be worthwhile to find resources for raising the average salary levels, which would most probably increase the motivation level of officials within the administration.

Another key challenge involves improving co-operation between various departments, including between policy departments and departments responsible for financial management.

**Developments in public expenditure management are currently carried forward without sufficient Kosovan ownership of these changes, and therefore the public expenditure management system does not support the actual decision-making process.**

#### **Recommendations for Assistance**

Currently the main area that would benefit from substantial support (and that also constitutes a prerequisite for the proper functioning of some other components of public expenditure, such as MTEF) is the strategic planning system and related processes and capacities. Another area in which the government would gain from international support the most would be assistance in harmonising various functions of public financial management, with the aim of ensuring that the entire cycle of public finances works logically and that the various functions provide support to each other. Most probably, support would be needed in developing a comprehensive reform agenda for public expenditure management as well.