



SIGMA

Support for Improvement in Governance and Management

A joint initiative of the OECD and the European Union, principally financed by the EU

KOSOVO

EXTERNAL AUDIT

ASSESSMENT JUNE 2007

1. Legal Framework

Regulation 2000/7 requires the Special Representative of the UN Secretary General for Kosovo (SRSG) to ensure that appropriate arrangements are established for an independent audit of the Kosovo Consolidated Budget (KCB). The Office of the Auditor General (OAG) has assumed responsibility for the external audit of KCB financial statements since the fiscal year 2004. The Court of Audit of the Netherlands was contracted to undertake this audit for the period 1999-2003. The OAG has now taken responsibility for undertaking the annual Kosovo Consolidated Budget audit; however, a small team of international experts is still providing support to the OAG for the audit of the KCB.

The Transferred Power Agencies (TPAs) as well as the Reserved Power Agencies (RPAs) receive funds from the Kosovo Consolidated Budget (KCB). The Constitutional Framework for Provisional Self-Government provides for the existence of an external audit of KCB resources with regard to their regular, efficient and effective use. This responsibility is assigned to the Auditor General of Kosovo, which is itself an RPA, assisted by the Office of the Auditor General (OAG). The European Union Pillar in Kosovo is responsible for ensuring the establishment of the Auditor General's Office.

The status of the OAG is defined by UNMIK¹ Regulation no. 2002/18. According to this regulation, the OAG shall:

- be independent of the SRSG and the PISG (paragraph 2.2);
- report to the SRSG (paragraph 3.1); the reports, containing the audit findings, are also to be submitted to the auditee, other institutional entities, including the Assembly of Kosovo, and copies of the report are also to be made available to the public (paragraph 3.3);
- prepare a confidential report for the Secretary-General of the United Nations concerning any information that the SRSG decides to not make public; this report is to be submitted to the Secretary-General, together with a copy of the written instruction issued by the SRSG (paragraph 4.10.3).

With regard to reporting, some of the previous restrictions have been removed. The SRSG can no longer proscribe special disclosure of the reports. However, the remaining restrictions on the freedom to report clearly go against the most basic standards of independence applicable to any supreme audit institution (SAI), which is presumed to decide in full autonomy about what, when and how to report. These restrictions may be justified, temporarily, by the current state of affairs in Kosovo, but the relevance of such a limitation should be regularly checked against the evolution of the context and removed at the earliest opportunity.

The OAG is to provide audit reports to the Assembly (paragraph 3.3.d). Upon the written request of the Assembly, the OAG may conduct a particular audit (paragraph 3.8). The audit reports and particular audits are the only functional linkages between the two institutions.

The OAG may at any time consult the institutions included in the audit remit "for the purpose of coordinating audit responsibilities" between the Office and "the requirements of internal audits for any of those institutions or entities" (paragraph 3.5).

According to Regulation 2000/7, the OAG is to conduct annually a regularity audit of:

- the KCB;
- the Assembly;

¹ Since June 1999 the province of Kosovo has been governed by the UN Interim Administration Mission in Kosovo (UNMIK).

- the Office of the President of Kosovo;
- each ministry and executive agency of the executive branch of the PISG;
- each municipality (approximately 30);
- the Central Banking Authority of Kosovo (previously the Banking and Payments Authority of Kosovo);
- other entities that either are publicly owned or receive funding from dividends or other non-tax revenue to the KCB, including the UNMIK Customs Service;
- the Kosovo Trust Agency;
- the Ombudsperson;
- other entities under UNMIK authority that receive funding from the KCB.

In addition to regularity audits, the OAG may conduct performance audits and provide other services of the kind commonly performed by an external auditor.

The regulation provides for the specific procedures needed to carry out audit work (free and unrestricted access to information and documentation, access to premises, etc.)

2. Institutional Framework

The Office of the Auditor General (OAG) was established in 2003. In September 2003 the SRSG appointed the first Auditor General, who was recruited from an EU Member State and had experience as an auditor general. The current Auditor General, who was appointed in January 2006, was not recruited from an EU Member State. The OAG has five audit departments, three supporting departments, an audit support unit, a public affairs office, and a staff unit serving as an advisory group to the Auditor General. A public affairs officer was recruited for the purpose of increasing the public's recognition and acceptance of the OAG.

The Auditor General is entrusted with the task of building up and "Kosovarising" the audit office. The OAG has now taken responsibility for undertaking the annual Kosovo Consolidated Budget audit and is performing numerous other audits of budget organisations. Nonetheless, international support has enabled the OAG to meet most of its mandate. The OAG outsources audits to international audit companies, and OAG staff provide assistance to these companies as trainees. In September 2006 the OAG published its 100th audit report. Local staff have now filled all administrative and support staff posts as well as all senior positions, i.e. human resources officer, budget officer, procurement officer, logistics officer, librarian, and head of IT. The middle management is also now fully Kosovarised. However, all auditors of the OAG are Albanian Kosovars despite active outreach efforts to employ minority communities.

In 2006 the Auditor General and the Deputy Auditor General started to have regular and extraordinary formalised management meetings with the directors of the five audit departments of the OAG. These five departments are assigned the audit mandates of all budget organisations. The audit areas are diversified, in parallel with on-the-job-training, so that the scope of OAG reports broadens to fully meet the OAG's mandate and audit responsibility.

The Strategic Development Plan was endorsed on 24 August 2006. The Strategic Development Plan was developed within the framework of the supporting project of the European Agency for Reconstruction (EAR) and the "creation and establishment of a supreme audit institution in Kosovo". The Strategic Development Plan covers the period 2006-2012.

The Plan incorporates proposed elements of the next phase of the technical assistance project for the OAG. The OAG has finalised the proposal for a "Law on Auditing of the Public Sector in Kosovo" The current regulation under which the OAG functions provides no opportunity for a regular relationship between the OAG and the Assembly. Currently the OAG reports to the SRSG, but this is supposed to be changed in the new legal framework. The aim is to give to the Kosovo Assembly and the OAG their

proper places and roles in the supervision of the Kosovo budget and other public finance. In this regard, the Auditor General should have the authority to apply directly to the parliamentary Committee on Budget and Finance. The main concern before presenting this draft law to the Assembly is the future status of Kosovo, as this has not yet been determined. Consequently the constitutional position of the OAG cannot be further established for the moment.

Some conflicts between the Ministry of Finance and the Auditor General remain, concerning remits, responsibilities and jurisdiction as well as the budget needed to perform the tasks of the OAG. It is deemed that these difficulties will be resolved once the Law on Internal Audit is promulgated by the SRSG (this law was approved in November 2006 by the Assembly). The apparent lack of financial independence of the Auditor General may also prove to be a problem. The Ministry of Economy and Finance still intervened regarding budget allocations for the OAG for the fiscal year 2005-2006. Currently the main OAG funding is allocated to the institution-building project as such and is provided partly by the UNMIK European Union Pillar and partly by the European Agency for Reconstruction. The KCB covered partly the outsourced audits up until 31 December 2006, and it fully covers the salaries of the audit and support staff as well as the operational costs of the OAG.

In 2006 the OAG started – with external help – to draft its own audit manual, suitable to Kosovar circumstances and reflecting the reality of the working environment, including its first experiences with audit work. The aim is to produce an audit manual covering each of the main stages of the audit process. The manual will be supported by prescribed forms, as well as guidelines on internal quality control assurance mechanisms. It is the OAG's intention to proceed in this direction and to ensure that those standards will be used in future audits.

On 19 December 2005 the professional Code of Ethics for the OAG was endorsed.

The OAG has a total of approximately 100 staff, about two-thirds of whom are auditors. The OAG has recognised that training needs are substantial due to the significant level of accountancy and audit training required for staff to obtain a professional qualification and to acquire the practical experience of translating theory into practice. The training programme, which was developed with significant contributions from international experts and in co-operation with the Society of Certified Accountants and Auditors in Kosovo (SCAAK), offers high quality training in all areas that are relevant for a modern external auditor.

The criterion to be qualified to perform audits is certification as an accountant, followed by a minimum of three years' training and work experience. Trainees carry out a ten-month intensive accounting and audit training. The training programme is completed with training-on-the-job in outsourced audits. In the past two years, the OAG has conducted intensive training for over 60 trainee auditors.

However, staff turnover is high, as staff leave the OAG as soon as they have passed their examinations. The main reason for this is that the salaries for OAG auditors are significantly lower than comparable salaries in the private sector. The OAG operates within the legal framework of the civil service. The Civil Service Law is being redrafted and a salary reform is envisaged. A salary and job classification policy for all local staff has been drafted, but in accordance with the Civil Service Law in force. According to the current Civil Service Law, no staff member can have an employment contract for more than three years, and the contract may or may not be renewed.

3. Reform Agenda and Capacities

The establishment of the Office of the Auditor General has been a project with many challenges. The intentions set out in the Strategic Development Plan are welcomed. A new EAR project has been launched, and the objective of this project is to further strengthen the operational and functional capacity of the OAG to perform its mandate by means of a capacity-building programme for improving the efficiency and effectiveness of public spending. This project is intended to assist in the implementation of

the Strategic Development Plan. As the current Auditor General is not a Kosovar and as there is still a fairly large number of international advisors, it remains unclear whether Kosovar officials will take ownership of the reform agenda that has been developed.

4. Assessment

In Kosovo, as elsewhere, priority should be given to establishing sound public internal financial control (PIFC) systems and procedures. At the same time, a suitable checks and balances system, with appropriate accountability mechanisms, has been established, but it has not yet been fully implemented within the public administration. To do that in the specific Kosovo environment will be a challenging task, and a balance will need to be established between transferred and reserved powers, as the OAG is still a reserved power.

An external audit function that meets INTOSAI auditing standards and related “good practice” approaches are being introduced. The legal framework may need to be amended in parallel to the development of the OAG to ensure the process of transferring further powers to the Office. This legislation should provide for a strong relationship between the OAG and parliament, the government and the administration. The Auditor General should report directly to parliament. The objective is to foster a spirit of trust between the public of Kosovo and the elected representative bodies. Special attention should be given to the regular contact of the Auditor General with the parliamentary Committee on Budget and Finance. It is also important to provide the OAG with adequate funding to perform its tasks, together with the necessary functional independence.

The Auditor General is responsible for the audit of the Kosovo Consolidated Budget (KCB). The Office of the Auditor General (OAG) is now operational on a basic level. However, it will be some time before the audit of the KCB can be undertaken entirely by the OAG's own staff resources, given the requirement for high quality audit. Training the staff of this young organisation up to the level of required standards will take several years, and continuing external assistance will be necessary throughout this period.

The Kosovarisation of the OAG management structure is fundamental for the long-term development, reputation and impact of the Office. Middle management positions are filled with Kosovar staff and hopefully, in the future, potential leaders will be selected from the existing group of auditors and audit department directors. However, their overall audit skills, management ability and capacity are still limited.

Basic functions are in place and the OAG has established a professional audit environment. This includes a fully functional IT infrastructure for the Office, PCs and software for all auditors and support staff, a basic library and archives, and a comprehensive audit manual. However, the challenge will be to apply the INTOSAI auditing standards, adapted to the Kosovar environment, through the audit manual and related guidelines. It will take a considerable amount of time and effort before a professional and Kosovarised supreme audit institution is fully established.

Building an organisation with its defined values and culture (*esprit de corps*) is also hampered by the implicit lack of administrative sustainability, as locally trained staff are not ensured a job position for longer than three years. The retention of audit staff – and all other staff – and the inclusion of minorities in all areas of the OAG are both important. To date the OAG still loses many of its most qualified staff, mainly because of the high differences in salaries between some public institutions and the private sector. An evaluation of the benefits could be made, reviewing the posts in comparison with the job classification, including conditions for attracting and retaining the best staff and a freer hand in recruitment.

The general situation is improving, although the OAG will still need support to continue to grow into its role as a key institution for the people and Government of Kosovo.

5. Recommendations

Many efforts have been made to establish proper accountability mechanisms in Kosovo. The basic elements for establishing an SAI were provided in 2002 by the above-mentioned UNMIK Regulation 2002/18. The development of a supreme audit institution takes time, and it will be some years before the OAG will be in a position to undertake the full range of audits envisaged – even with the current legislation – and to take an active part in discussions on the execution of the state budget.

The newly launched EAR project, which is fundamental to success in establishing a fully functioning and effective SAI in Kosovo, is a means of moving in the direction of developing the OAG into an efficient and accepted audit institution that is able to contribute to building a sound public finance base in Kosovo and of ensuring the validity and efficacy of accountability mechanisms. Attention should be paid to the phasing out of restrictions weighing on the freedom to report, to the further strengthening of the relationship with parliament, and in general to the way in which the future of the institution is organised once the situation in Kosovo is fully stabilised.

In particular, measures should be taken to ensure the adequate budget of the Office of the Auditor General. Further actions to raise awareness among the nearest stakeholders – i.e. parliament and the government – regarding the role and function of an audit institution would be useful. They would also pave the way for the full Kosovarisation of the SAI.

It is also important to focus on the borders between the “project” and the “day-to-day” operations of the OAG. Theoretically the “project” is aimed at providing support for the establishment of the capacity and proficiency of the OAG, whereas the “day-to-day” operations are the responsibility of the audit staff under the control of the Auditor General. Over time the OAG management should take over more of the “project” responsibilities, with the objective of fully assuming the responsibilities of a supreme audit institution (SAI). A roadmap with a timetable should be drafted to identify specific “handover” milestones.

In addition, it is important to develop and establish the organisational values and culture (*esprit de corps*). This is particularly challenging, as the length of staff contracts is only three years according to the Civil Service Law. As this law is being overhauled, a review should be carried out to analyse current posts in comparison with the job classification, including conditions for attracting and retaining the best staff and ensuring a freer hand in recruitment, together with a long-term human resources strategy. Experience has shown that it takes at least ten years to establish a modern audit office, and it takes an average of four to seven years to properly train a professional auditor.

The development of the SAI in Kosovo should not be undertaken in isolation. Progress in the development of related areas of public internal financial control and notably internal audit should be monitored and co-ordinated. Common development activities should be identified and encouraged in order to use scarce resources in a rational way. It is equally important that the parliamentary Committee on Budget and Finance take an active role in constructive debates on the execution of the budget. The Auditor General plays an important role in this debate.

6. External Assistance

The European Agency for Reconstruction (EAR) is supporting a project for the establishment of the OAG as well as a project for the development of internal audit.

With regard to the OAG, the EU funded the “Support to the Creation and Establishment of a Supreme Audit Institution in Kosovo” project (CARDS 2001), managed by EAR. This project started in May 2003 and was originally set for 44 months – this period expired at the end of October 2006. The project assisted in setting up the Office and in its development from the very beginning. An audit support unit, comprising three long-term audit advisors, was also established.

A follow-up EU-funded project, “Office of the Auditor General Audits” (CARDS 2006), started in February 2007 and will close by the end of May 2007. The aim of this project is to support the OAG in carrying out its annual audit plan.

A new project has been launched under the CARDS 2006 project with a budget of €1,500,000 and staff inputs of 1550 working days. The aim is to assist in the implementation of the Strategic Development Plan.

The successful implementation of these projects will contribute to a comprehensive, coherent strategy for the improvement of governance and public accountability in Kosovo.