Public Internal Financial Control Strategy 2015-2019

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Contents

List of acronyms / abbreviations

ACCA Association of Chartered Certified Accountants
AI Administrative Instruction
BO Budget Organisation
CAATS Computer-Assisted Audit Techniques
CAO Chief Administrative Officer
CEO Chief Executive Officer
CFO Chief Financial Officer
CHU Central Harmonisation Unit
CIPFA Chartered Institute of Public Finance and Accountancy
COBIT Control Objectives for Information and Related Technology
COSO Committee of Sponsoring Organisations of the Treadway Commission
CPD Continuing Professional Development
CPE Continuing Professional Education
DG Directorate-General
EC European Commission
ENPI European Neighbourhood and Partnership Instrument
EPAP European Partnership Action Plan
EU European Union
FMC Financial Management and Control
GFS Government Finance Statistics
GIZ Gesellschaft für Internationale Zusammenarbeit GmbH
(German Technical Cooperation)
HR Human Resources
IA Internal Audit
IAS International Accounting Standards
IFAC International Federation of Accountants
IFRS International Financial Reporting Standards
IIA Institute of Internal Auditors
IMF International Monetary Fund
INTOSAI International Organisation of Supreme Audit Institutions
IPA Instrument for Pre-Accession Assistance
IPPF International Professional Practice Framework
IPSAS International Public Sector Accounting Standards
IT Information Technology
KACA Kosovo Anti-Corruption Agency
KFMIS Kosovo Financial Management Information System
LIA Law on Internal Audit
LPFMA Law on Public Financial Management and Accountability
MoF Ministry of Finance
MPA Ministry of Public Administration
MTEF Medium Term Expenditure Framework
OAG Office of the Auditor General
OECD Organisation for Economic Cooperation and Development
OPM Office of the Prime Minister
PAR Public Administration Reform
PEFA Public Expenditure and Financial Accountability
PEMPAL Public Expenditure Management Peer Assisted Learning
PFM Public Financial Management
PFMRAP Public Financial Management Reform Action Plan

PIFC	Public Internal Financial Control
SAP	Stabilisation and Association Process
SIGMA	Support for Improvement in Governance and Management
SCAAK	Society of Certified Accountants and Auditors in Kosovo
TA	Technical Assistance
ToR	Terms of Reference
UK	United Kingdom of Great Britain
USAID	United States Agency for International Development

1 Executive summary

The Public Internal Financial Control emerged as a framework for ensuring appropriate level of control of management of public resources in the new member states of the European Union. It provides the legal, organisational and methodological basis for compliant, efficient, effective and economic spending of public funds and safeguarding of public assets.
The PIFC brings in also monitoring over the functioning of the public finance management systems and internal auditing to help the organisations with identifying the risks and taking measures for their mitigation.

The Government of Kosovo has completed the negotiations with the EU on the Stabilisation and Association Agreement (SAA) in May 2014 and the SAA is initialized in July 2014. Such agreement includes options for Kosovo to receive more substantial financial support from the EU under different funding schemes. Instrument for Pre-Accession Assistance (IPA) II Indicative Strategy Paper for Kosovo 2014-2020 has been adopted in August 2014 and it sets out the priorities for EU financial assistance for the period 2014-2020 to support Kosovo in fulfilling its European perspective. The document is addressing the importance for Kosovo to have credible and relevant programme to improve public financial management as one of four key condition need to be met as concerns sector budget support. The functioning of solid and reliable PIFC system, as important part of the overall public financial management system, has always been a condition for receiving EU funds. Such system provides also for better management and reducing the risks of inefficiencies and waste of public resources from the own national budget of Kosovo.

The PIFC has been under implementation in Kosovo since 2005. Ever since, the major legal and organisational conditions have been established. The capacity building is progressing especially in the area of internal auditing, where 68 people have internationally recognised professional CIPFA UK certificate. This first phase of establishment of the PIFC conditions should be considered as completed and now it is time to look forward to the new challenges in the areas of good governance, public finance management, internal control and internal audit.

The subject of this Strategy is the new phase of the development of PIFC, which is characterised by risk based management of public resources, intensive utilisation of management information systems, well designed controls for risk mitigation with high level of automation. This new phase of development requires additional professional knowledge, managerial accountability and advanced internal audit helping the organisations to achieve their objectives.

Key objectives of the Strategy

1. ***Controls over inputs and resources are integrated in the public finance management system and processes by 2017;***
2. ***Managerial accountability on inputs and management of resources in place, verified by dedicated reports prepared by the managers of public funds by 2017 - 2018;***
3. ***Risk management in place in each budget organisation, verifiable by risk management structures and reports by 2017;***
4. ***Internal audit function adds value to the accountable management by providing risk focused assurance and advisory services, verifiable by economy, efficiency and effectiveness indicators by 2019***

Short summary of the agreed and recommended actions and measures

For the implementation of the Strategy, the Government of Kosovo will improve further the legal and organisational basis, provide resources for modernisation of the management information systems and support the capacity building at central and local level and in the public sector entities so that the objectives of this Strategy are achieved.

The Ministry of Finance will be the leader of the PIFC reform and for this purpose the Minister of Finance will chair a PIFC Council, the director of CHD will act as a member, and CHD itself will act as a secretariat to the PIFC Council.

The Government of Kosovo anticipates that the international community and the EU in first place will provide the necessary support and technical assistance for the implementation of the Strategy.

For the achievement of **Objective No. 1: Controls over inputs and resources are integrated in the public finance management system and processes by 2017**, the following measures will be introduced:

1. Institutional building, including the establishment of the PIFC Council to discuss and make decisions on changes in different PFM processes, regulations, cross cutting issues, preparing information to the Government on the actions that require the endorsement of the Government or the Parliament.
2. Strengthening the capacity and competences of the CHD to be the manager of the PIFC reform by amending their duties, responsibilities and by providing adequate resources to them.
3. Amendments of the legal framework to provide for sound and systematic control over inputs and resources, including changes in the segregation of duties, power, authority and accountability for managing public funds.
4. Review of the exiting controls, assessment of their adequacy and effectiveness, automation and integration of controls in management information systems.

For the achievement of **Objective No. 2: Managerial accountability on inputs and management of resources in place, verified by dedicated reports prepared by the managers of public funds by 2017 – 2018,** the following measures will be introduced:

1. Amending the legal framework to make the Heads of budget organisations responsible for both – implementing governmental policies and managing public resources by signing the MTEF, annual budgets and financial reports of the organisations they are in charge of. In the second phase the managers of programmes will be made responsible and accountable for the delivery of services. Programmes should have clear objectives that should be e achieved in accordance with the three E principles.
2. Increasing the CFO's responsibility to control management of public funds, risk management of such threats as incompliant budgeting, and spending, entering into contractual obligations leading to outstanding liabilities, arrears, and poor safeguarding of assets.
3. Introduction of Internal Control Statement as part of the financial report and as materialisation of the managerial accountability.

4. Improving the programme budgeting and reporting with objective and performance indicators (putting proper links between strategic planning and budget resources).

5. Expanding the functionalities of the KFMIS to provide and process additional financial information (management accounting and costing) to supply information on performance budgeting and financial analysis of the activities to enable managers to assess efficiency and effectiveness.

The achievement of **Objective No. 3: Risk management in place in each budget organisation by 2017,** envisages the following measures:

1. Amendment of the PFM legal framework for compliance with Risk management requirements including obligation for establishing risk registers, reporting and presenting the priority list in MoF and alignment of FMC manual with COSO model.
2. Implementation of risk Identification and assessment process in line with improvement of internal controls and integration into KFMIS, related to PFM process described under the first objective.
3. Capacity building and training for managers to take risk into account when planning the actions for service delivery and achievement of policy objectives.

The achievement of **Objective No. 4: Internal audit function adds value to the accountable management by providing risk focused assurance and advisory services, verifiable by economy, efficiency and effectiveness indicators by 2019,** entails the following measures:

1. Updating the legal framework to ensure compliance with the ISPPIA: amending the LIA and the secondary legislation in order to reflect the organisational changes of CHU/IA as a part of one CHU, update of the criteria for licencing of internal auditors and establishment of Audit Committees; updating the IA Manual.
2. Implementing a programme for professional development and carrier promotion: Introducing national certification scheme, maintenance of the international certification, on the job training and mentoring to address the issue with application of theoretical knowledge in practice; securing resources for training and carrier promotion; including IA profession in the civil servants' job classification with the special salary coefficient.
3. Implementation of quality assurance for compliance with the ISPPIA: Quality Assurance and Improvement programmes developed by each IAU, including internal assessments and peer reviews. The CHU/IA should have their own IAU's monitoring programme to define the areas of incompliance with the ISPPIA and to recommend actions for solving the matter on annual basis.

2 Introduction

The concept of Public Internal Financial Control has been developed by European Commission in order to support candidate and potential candidate countries in reforming their system of managing and controlling of public funds. The concept is based on international standards of internal control in the public sector and the best practice of EU countries. The establishment and reliable functioning of a PIFC system are subject to monitoring in the EU accession negotiations and the requirements are defined in Chapter 32 "Financial control".

The PIFC concept has been under implementation in Kosovo since 2005. Ever since, significant progress has been made, guided by previous PIFC Policy Papers, resulting in creation of solid basis for the next stage, which is the subject of this strategy. The new stage will be about implementation of integrated controls over public funds and resources requiring considerable improvement of the legislation, institutional and management capacities and adequate utilisation of information technology systems.

The development of PIFC is on-going process and it is part of the wide Public Administration Reform. Objectives set in this Strategy will have direct impact and support the implementation of Government priorities set in other documents which are related to the European agenda and Public Administration Reform.

Further improvements in the area of public internal financial control should be considered as important steps in the EU approximation process. Strengthening the financial controls is one of the priorities mentioned in the Public Administration Reform chapter of the **Stabilization and Association Process Dialogue.**

The good governance and improvement of the public finance management are also priorities of Government of Kosovo, stated in the **Declaration of Medium - Term Policy Priorities 2014-2016 from April 2013.**

The improvements in the system of internal financial control will also contribute to the implementation of the **Anti-corruption Strategy 2012-2016.**

3 Approach used for the development of the PIFC Strategy

The Strategy has been prepared on the basis of in-depth analysis of the current situation in the area of Financial Management and Control and Internal Audit in the public sector in Kosovo, including:

- review of the legal framework,
- functioning of administrative structures,
- division of powers and duties in public finance management,
- requirements for managerial accountability,
- implementation of the regulations,
- adequacy and efficiency of the internal controls in the public sector,
- risks of inefficient use, waste and mismanagement of public resources and assessment of the existing prevention mechanisms.

The preparatory work included interviews with key stakeholders and decision makers in the PFM and PIFC process, such as the Heads of the Budget Departments, Head and Deputy Heads of Treasury, Head of the MoF' EU Integration Department, Head of the POE's Monitoring Department in the Ministry of Economic Development, senior managers from the OAG, budget organisations and donor institutions.

The Strategy is a document addressing the next five years aiming at improvement of the system of financial management and control facilitating efficient public spending, better public service, guaranteeing transparent and compliant utilisation of the national budget of Kosovo, donors grants and borrowed funds. Therefore the focus of the analysis and interviews was not only on the current strengths and weaknesses but more on the requirements deriving from the Stabilisation Agreement for Kosovo with the European Commission, needs for developing of capacities for advanced management of public services and funds under different financing schemes, public-private partnerships, regional agreements between several parties etc., which the Government of Kosovo should explore for accelerating the process of social and economic development of the country.

The Strategy has been prepared by the Working group consisted of institutional representatives:

1. The Assembly of Kosovo,
2. The Office of the Prime minister,
3. The Office of the Auditor General
4. Ministry of Finance,
5. Ministry of Local Government Administration,
6. Ministry of Culture, Youth, and Sports,
7. Public Procurement Regulatory Commission, and
8. Kosovo Property Agency.

The support in the preparation of the document has been provided by EU funded PIFC project.

4 Background

The key problem addressed in the PIFC Strategy 2015 – 2019 is improving the adequacy and efficiency of the financial management and control system in order to protect the public resources of Kosovo, EU, other donors and international finance institutions from mismanagement, incompliance and to ensure that public funds are used to provide better public service in Kosovo.

The PIFC has been under development in Kosovo since 2005, supported by several EU TA projects. As a result, the legal framework, organisational structures and controls in key and risky processes have been established. The capacity building in the area of internal audit has been done by introducing internationally recognised certification programme – CIPFA UK. The internal audit function is now an integral part of the public sector.

Now, the Government of Kosovo is entering into the next phase of cooperation with the EU and has to prepare a strategy for meeting the conditions from the Stabilisation and Association Agreement.

The areas which need the attention and action of the Government are:

- To develop risk-based control environment;
- To improve efficiency, effectiveness and economy of operations;
- To increase reliability of financial reporting;
- To do better planning and budgeting arrangements;
- To continue the introduction of the managerial accountability concept together with strengthening the culture of delegation of responsibilities and authorities. [1]

The major problem that should be addressed is the integration of the controls required by the legislation in the processes, introducing risk assessment and risk management for the achievement of the objectives of the government' policies and elaborating an adequate model for exercising managerial accountability within the current stage of maturity of the society and public sector in Kosovo. The strengthening of the financial management and control system should be complemented by highly professional internal audit services.

Detailed overview of the different elements of the PIFC system is presented below.

4.1. Financial Management and Control

4.1.1. Regulatory framework

The PIFC legal framework contains the overall principles and refers to globally accepted standards, but it needs to be amended with the changes in the development of the FMC and IA. The implementation of the legislation is not sufficiently consistent and in many cases not supported by adequate structures, skills, management tools and information systems.

Primary legislation - the legal basis for internal control is set by the **Law No. 03/L-048 on Public Financial Management and Accountability (LPFMA),** which is the organic budget law.

[1] Reference: EC Working document accompanying the document Commission Communication on a Feasibility Study for a Stabilisation and Association Agreement between European Union and Kosovo, page 40

Secondary legislation is provided by two Treasury Rules governed by the LPFMA:

- Treasury Financial Rule no. 01 on Public Internal Financial Control from 30.07.2010 presents the COSO framework and the accountability principles in the context of the responsibility chain in the public sector of Kosovo. Most of the provisions in this regulation should have been stipulated in a Law. For instance the accountability of the Members of the Parliament and Executive Heads of central and local governments, the entire set of FMC terminology and its interpretation in the context of the public sector of Kosovo.

- Financial Rule No. 01/2013/MF on Public Funds Expenditure covering expenditure and internal control and the decentralization of expenditure management to budget organisations.

Tertiary legislation – The FMC Procedures Manual enforced in 2011, contains 14 procedures aiming at covering all areas of the budget cycle. The FMC Manual could have been used by the budget organisations if they had proper management information systems where controls are part of the processes with some guidance provided by the CHU/FMC and if there was rigorous accountability and reporting mechanism. These conditions have not been in place at the time of the enforcement of the FMC Manual.

There are several administrative instructions issued by Ministry of Finance concerning accounting, financial reporting, costing of new policy, and management of non-financial assets:

- Administrative Instruction No. 01/2013/MF on Setting Out the Form, Content and Procedures for Costing of New Policy Initiatives;
- Financial Rule No. 02/2013/MF on Reporting of arrears by Budget Organisations;
- Regulation No. 03/2013 on Annual Financial Statements in Budget Organisations;
- MoF Regulation No. 02/2013/MF on Management of Non-Financial Assets by Budget Organisations.

Internal instructions and operational procedures of BOs

For managing the daily operations the BOs work under the general regulations and do not have many specific internal regulations for financial management, internal control, human resources and other topics related to FMC. Considering the size of the BOs in Kosovo, specific rules are really needed for large systems serving complicated and high risk processes – Tax collection, Customs, Police, Education, Health care, Pension and Social Affairs etc. Such rules are partly developed, but there is still work do be done.

The majority of the budget organisations are small in terms of budget, staff, assets and do not manage complex or risky activities. Significant part of their budget is spend on remuneration and utility cost. The provision and financing of public services is for covering operational cost and not at full cost recovery level in many cases. Therefore, such organisations could be able to manage their operations without written internal procedures if the general regulations were supported by management information systems reflecting the rules.

4.1.2 Institutional and organisational structures

The Ministry of Finance

The Ministry of Finance is in charge for the development and implementation of the financial management and control of public funds and resources in Kosovo. The FMC tasks are divided between the departments responsible for the key PFM processes – Budget, Treasury, Tax. Since 2014, there is a Central Harmonisation Department for FMC and IA that is a merger of two separate CHUs for FMC and IA that have been previously in place. The primary task of the CHD (CHU) is to coordinate, harmonise and monitor the financial management and control system and ensure the compliance of the internal audit function with the professional standards in this area. The organisational restructuring has been intended as a step in strengthening the position of the unit and bringing in one hand the responsibility for the overall development of the internal control and internal audit.

Pursuant to article 6.2 of the Law on amending and supplementing the LPFMA 2013, CHU FMC shall develop strategic documents, guidelines, drafting laws, secondary legislation, and policies for improving FMC. The amendments did not take into consideration that according to the COSO model controls are an integral part of all systems and processes. In this regard FMC requirements should be seen as imminent component of the design and functioning of any PFM process.

Moreover, the role of the key departments and owners of the PFM processes in the Ministry of Finance has not been taken into consideration. The CHD cannot fulfil its duties under the current legal and organisational framework. Related to this, the provisions in the LPFMA and appropriate reassignment of the FMC responsibilities should be reconsidered. The LPMFA should be amended in order to regulate the FMC duties, responsibilities and powers among all stakeholders . The LIA should bring the provisions for internal auditing in line with the ISPPIA.

Other matters that have to be addressed by the CHD is the capacity of the staff and the proper segregation of their duties such as specialisation in FMC training, FMC monitoring, FMC methodology and other issues. Concerning the expected changes in the PFM area, access to EU funds, modernisation of the financial management and control system, the CHD should anticipate the need of further strengthening of their capacities, knowledge and skills together with improving the quality of the internal audit.

4.1.3 Integration of controls in PFM processes

The MTEF is prepared by the Budget Department of the MoF in cooperation with the Macroeconomic and Forecasting Department. The budget organisations are required to fill in information about their ongoing, new activities and respective funding in a template provided by the MTEF instruction.

Project Investment Planning is done by the budget organisations in a software application PIP, managed by the Budget Department. The information is used for the preparation of the annual budget, the mid-year review of the budget execution and control of investment projects. The revenues and recurring expenditures for the annual budget are provided in another software application BDMS.

The monetary transactions are executed by KFMIS which is a customised version of Free Balance, managed by the Treasury. The Treasury Single Account is served by the KFMIS. The non-monetary transactions such as registration of assets and liabilities are recorded in Excel tables by the budget organisations. The Asset module of KFMIS is not integrated with the Payment module. Cash management is done in Access.

Financial reports are partially generated by the KFMIS and partially by compilation of data from Excel tables.

Property tax is managed by the software application, owned by the Property Tax Department in the MoF.

There is E-procurement system for registration, management and monitoring of public procurement. Systematic monitoring of the financial position and financial results of the Publicly Owned Enterprises not in place yet.

Some of the important processes such as Revenue collection – Taxes and Customs duties have not been evaluated yet, but they should be included in the future analysis of the FMC and integration of controls.

The individual software applications are not sufficiently integrated. Each of them has separate database and the information needs additional reconciliation, verification, disclosure checks. The IT data management is also not integrated. Each process owner has a separate IT service.

The integration and additional automation of the controls in the public finance management processes requires a set of activities in the implementation of the PIFC Strategy.

4.1.4 FMC in budget organisations

Budget organisations are required to apply general financial management rules defined by the Ministry of Finance. As stated above, the legal framework is relatively comprehensive but not consistently applied. Formally, each organisation has the required structures and officers with assigned duties and responsibilities in line with the legislation.

There are issues that need to be addressed at the level of budget organisation both deriving from the status of the development of management information systems and legal requirements given by the Ministry of Finance:

1) The risk of possible actions outside of the legal framework has never been assessed. Therefore, there is lack of adequate controls integrated in the Budget, Treasury, Tax and other revenue collection systems. This situation represents a threat of incompliant, uneconomical, inefficient and ineffective budget preparation, budget approval, spending, management of assets and liabilities and unreliable reporting on the financial position of organisations. Many examples of such weaknesses are presented in the reports of the Office of the Auditor General and the internal audit reports.

The organisations are still in the phase of fixing the controls over inputs – compliant management and reporting about resources, spending and safeguarding of assets. Budget organisations are not provided with adequate management information systems. The access and the functionalities of KFMIS are limited and do not meet the needs for timely and complete information of the BOs. The budget organisations do not have their own financial management information systems. The lack of accessible information provided by information technology systems does not allow for proper monitoring and control over planning and spending of public resources.

The set up and upgrade of Management Information Systems with inbuilt controls reflecting the legal provisions and the integration of those systems should be a priority for the first two – three years of the implementation of this strategy.

2) The responsibility and accountability lines, although formally compliant with the legislation, do not provide for efficient control over public resources and implementation of public policies. The Head of the budget organisation who is in charge for the implementation of the policy does not have formal responsibility and is not held accountable for the spending of the public funds. The Certifying officers are empowered to approve expenditures within a system (KFMIS) that does not reconcile commitments, contracts, expiration dates, limits for cash payments etc., there is not clear segregation of duties between CFO and the Certifying officer. Both officers are carrying out financial controls and there is an overlap of responsibilities. The certifying officer is supposed to carry out the Treasury controls, but he/she remains an employee under the Head of organisation duplicating

internal controls which belong to the CFO. This brings to a situation where the CFO or other operational managers do not feel entirely responsible and accountable for their actions.

3) Outputs and outcomes are not controlled yet. This should be seen as a second phase of the implementation of the strategy from 2017 onwards. For the implementation of such controls, the Government has to create conditions for the real implementation of programme budgeting, integrate the operational expenditures with the capital expenditures by programme and project, link them to a sector policy, develop reasonable, measurable and achievable indicators. Management by objectives and control over outputs and outcomes depends entirely on the progress of the reforms in the policy making, strategic planning, advanced budget planning, modernisation of the treasury etc. Therefore, it is not possible to foresee concrete measures in the FMC part unless there is no overall PFM strategy.

4.1.5 FMC in PFM processes

Budget planning

Budget preparation is regulated by the LPFMA, annual budget circular letters and served by two software packages BDMS and PIP. The Medium Term Expenditure Framework (MTEF) has sector ceilings, budgets are divided by activities, The first year of the MTEF provides indicative figures for the annual budget. There is no legal provision for approving the MTEF by the Parliament. Therefore, it is very often subject to changes by the Government or powerful ministries. There are also some weaknesses in the MTEF itself due to the lack of clearly defined objectives and actions in the strategic plans by sector leading ministries or local self-governments. The absence of links between strategic documents, MTEF and annual budget has been indicated in several monitoring reports of international organisations.

An additional issue is that strategic plans, MTEF and annual budget do not contain risk assessments for the most obvious issues such as delays in implementation of complex projects, gaps in strategies, timely planning of the full cost.

Risk mitigation measures are not envisaged and problems are resolved ad hoc at the expense of cutting cost wherever possible. Many of the planned activities and related spending are modified, changed, put on hold or the budget year ends with substantial liabilities as it happened in 2013.

In this regard, the entire budget preparation process and the tools for its management have to be scrutinised for adequacy and effectiveness of controls so that the internal control system guarantees the achievement of the strategic objectives by allocating sufficient funds and timely mitigation of the risks.

For improving the FMC in the budget process the following matters have to be addressed by the joint effort of several key players in the period 2015 - 2019:

- Establishment of Fiscal Council at the level of the Government to decide on priorities and necessary funding well ahead before the start of the MTEF preparation;
- To link the government priority setting and public spending through budget ceilings by the Ministry of Finance and the Office for Strategic planning;
- The Heads of the Budget Organisations and Heads of Line Departments should be provided with budget allocations to implement the projects and activities they are in charge for. They should be held accountable for the public service provided and for the resources spent for the service provision or implementation of the projects. In this respect the role of the finance department should also change;
- Risk assessment and fiscal impact reviews have to be carried out before introducing any new programme in order to avoid approval of policies and laws without securing the funding sources.

- In order to implement the above measures, changes should be introduced in the relevant legal acts and secondary legislation;
- The human resource capacity of the sector / line departments for programme budgeting has to be increased;
- This new approach of budgeting has to be supported by management information system providing the necessary information, maintaining complete and up to date database, offering automated solutions for calculation, analysis, reporting etc.;
- The budget should be prepared by using complete budget classification. Based on the budget classification the Budget Department should monitor the budget execution.
- Monthly budget allocations should be used for the Cash planning.

Budget execution

The budget is executed via Treasury Single Account which provides for control over all cash inflows and outflows related to the budget. The cash flows are managed by Kosovo Financial Management Information System (KFMIS) using some of the modules of the commercial software Free Balance. There are commitments, payment and asset management modules. The system is used by all budget organisations. The access and user levels are regulated based on decentralised system of approval of payments. The Treasury does not control the compliance, completeness or justification of commitment or payment. This is entirely in the hands of the authorised officers in the budget organisation.

There are several problems with the KFMIS that need to be addressed in order to improve the control over compliance with rules and regulations, economical and efficient spending of public funds and management of revenues, assets and liabilities. Some of the shortcomings of the management information system have been mentioned above. A detailed list of the problems, risks and action to be taken in the coming two years is shown below:

- Treasury has to prepare a modernisation plan for KFMIS and secure funding for its upgrade, maintenance and training of users.
- The system should be:
    - web-based - to solve the accessibility problem,
    - integrated - possibly using one database. In case of incompatibility to use a minimum number of databases; this concerns the Free balance modules and its compatibility with other software as BDMS, PIP, public procurement registry, National Bank software and others,
    - providing for registration of monetary and non-monetary (receivables, liabilities) transactions at the level of budget organisation,
    - providing for standard and customised reporting,
    - anticipating the plans for introduction of IPSAS on accrual basis and any other PFM reforms required.
- Before the acquisition or customisation of the KFMIS, the design has to be scrutinised for inbuilt controls to ensure that the legal provisions have been converted in a proper control mechanism.

This integrated IT solution will mitigate most of the currently existing risks of mismanagement of public funds and will decrease substantially the risk of human error or discretional decisions on matters that are regulated by law.

The second advantage of centrally supplied ITS for financial management is that this is possibly the cheapest solution for Kosovo, considering the scale of operations and resources guaranteeing security, integrity, reliability of data and transactions.

Public Procurement

About 50% of the Kosovo budget is spent via public procurement procedures. The legal framework is rather comprehensive and is subject of strengthening on an on-going basis. The major problem with public procurement is the transparency of the procedures and the existing practice to break down procedures in smaller lots.

In this regards, the ideal situation would be the introduction of e-tenders and this should be the long term solution for achieving the objectives of the public procurement process: compliance, economy efficiency and effectiveness of public spending.

In the short term prospective, the issues with the capacity of the staff involved in preparation of technical specifications, early stage control for preventing omissions in the completeness of the terms of reference or specifications. Control over preconditions should be in place, such as land available to build, checks for preventing splitting of tenders in smaller lots These shortcomings have to be addressed by introducing some measures as:

- Link between the PIP software with indicative information on the number of PP lots;
- Inclusion of all parts of a project under one single project code (acquisition of land, construction plans, preparation of infrastructure) in PIP, BDMS and PP software;
- Control over commitment of funds in a sequence in KFMIS, for example prohibition of commitment for construction plans without commitment for land acquisition;
- Amendment of legislation should include sanctions for the persons in charge for any omission to adhere to legal provisions for example for intentional breakdown in more lots than needed;
- Registration of PP contracts in KFMIS for the entire period of implementation with automatic pre-commitment of funds for the next budget period and automatic rejection of payments for expired contracts without registered annexes for extension;
- Regular control and monitoring over the list of eligible Economic Operators (EOs);
- Customised PP training addressing the weaknesses in PP process for managers.

Payroll system

The payroll system is managed by MPA. The Central Civil Servants' Registry is a system that interacts with the database of the payroll system and the database of compulsory pension insurance and income taxes. Personal records of civil servants are still kept in hard copies only. This does not provide for timely update in the centralised payroll system. In addition to this the payroll system does not allow for continuous update of the civil servants' status (hired/retired/suspended). This issue should be addressed by automation of personal records and the upgrade of payroll system:

- the automated HR management system should include the registry of staff on labour or service contracts;
- the HR and payroll IT systems have to be scrutinised for compliance with the legal provisions and calculation of any payments and allowances for personnel.

Capital investment projects

The capital expenditure planning needs improvement and differentiation between capital expenditures and maintenance cost and their proper planning in the PIP and BDMS. Many of the CAPEX belonging to one project instead of being managed by one department are divided among several units. Such practice does not allow for responsible management and control over planning and implementation of capital investment.

The major issue with capital investment projects is that they are currently financed by the annual revenues of the Kosovo budget. In the long term, the Government of Kosovo should develop capacity for capital investment from long term borrowing and conditional grants from international banks, finance institutions and donors.

Subsidies / Grants

There is a relatively adequate regulation on the funding of public services by grants and subsidies such as education and health care. There are still problems with the statistical and other information needed to justify the grants. The existing criteria and factors should be reviewed for relevance. In addition, all sectors allocating grants and subsidies should establish and update their rules, and make sure they are automated in BDMS, KFMIS and other systems.

Accounting

The LPFMA requires IPSAS compliant cash basis accounting. As the Ministry of Finance and Treasury have been very focused on the control over cash flows the accounting information on non - monetary transactions and their reflection in the financial statements have been left behind. Most of the issues and measures to be taken in the short term have been presented under the Treasury chapter above. All of them have to be considered as priority matters as the accounting is an area of high concentration of important financial controls.

Treasury is currently in charge for both - the preparation of financial reporting methodology and consolidation of financial reports. This arrangement does not provide adequate segregation of duties and represents a risk for the quality and compliance with IPSAS of the financial reporting guidelines and other accounting methodology and for the control over the completeness of the financial reports prepared by the budget organisations. Preparation of accounting methodology as a substantial part of the financial control should be assigned to a separate unit, possibly within the CHD (CHU) and arranged in the LPFMA .

Reporting and Monitoring

The reporting by budget organisation needs further regulation in terms of publishing reports on both -achievement of objectives, performance of activities and management of public resources – financial reporting. Currently only few budget organisations, mostly municipalities publish such reports and this is not done on a consistent basis. This matter should be regulated in the short term with detailed instructions, templates and possible automation and links to the MTEF, budget planning.

The option of introducing a statement on financial controls by the CAO as a part of the financial reporting should be considered as part of the intended implementation of managerial accountability.

Relations between Government / Local Self-governments and Publicly Owned Enterprises

Control over delivery of public services such as water supply, water treatment, garbage collection, transport etc., together with the management of public resources and funds needs further development of the legal framework, mechanisms for effective management and accountability for the provision of the public service. This is an area that needs complex approach and change in the relations between the owner and the appointed management as the public services in question are in a very unsatisfactory condition.

There is legislation in place and a designated unit in the Ministry of Economic Development monitoring the performance of the POEs at central level. The problem with the monitoring activities is that they are not risk focused and do not provide for any early warning or risk mitigation in case of common threats like problems with liquidity, debt service, collection of revenues, timely execution public investment programmes etc. A comprehensive methodology for monitoring the fiscal risk of the POEs should be developed and implemented at central and local level.

Monitoring of the FMC (self-assessment and internal audit)

Monitoring of financial management and control system is carried out with the purpose to evaluate its adequacy and to ensure its timely updating taking into consideration the identified weaknesses and/or areas for improvements.

Currently monitoring is performed on the basis of self-assessment questionnaires developed and summarised by the CHU/FMC in an annual report. The CHU/FMC is in process of gaining experience and getting more skilled in adjusting the questionnaire to the real risks and critical areas for the budget organisations so that the systems in charge for certain area of control are improved at national level or to provide individual guidance to the budget organisations in solving specific cases.

The practice of other countries shows that another useful tool for strengthening FMC and helping the budget organisations is the monitoring on the spot done by the CHU/FMC. The Ministry of Finance should consider introducing this tool in order to support the budget organisations in the implementation of the FMC, using the FMC Manual, enhancing their capacities in risk management etc.

4.1.6 Managerial Accountability

Managerial accountability can be successfully introduced only when the organisations and the stakeholders in the public sector are mature enough, supplied with adequate tools and reliable management information systems. Many of those conditions are in a development stage, especially the management information systems. As stated above the managerial accountability, delegation of duties should be addressed in the amendments of the LPFMA . In addition, the new legal provisions should be adequately reflected in the MIS system.

In order to reflect the situation and potential of the public sector managers in Kosovo there are two stages of development of the managerial accountability suggested. The first stage is accountability over inputs and resources as described above, including the integration of controls and compulsory reporting. This type of accountability should be introduced in the period 2015 – 2016.

The second phase is accountability over outputs and outcomes which should be introduced as part of programme budgeting with performance indicators, development of the information systems processing and recoding the data for the outputs. Managers should be able to carry out analysis on the achievement of the objectives and report on outcomes. This phase can only start when proper strategic plans, programmes, budgets, expenditure management and information systems are in place. This should be envisaged for the period after 2016.

4.2. Internal Audit

4.2.1. Regulatory framework

The legal framework for Internal Audit includes the LPFMA and Law on Internal Audit. The criteria for setting internal audit function, licencing of internal auditors, functioning of Audit Committees are stipulated in several administrative instructions. Legal provisions regulating internal audit function are out-dated and do not reflect in full the requirements of ISSPIA. The updates should be stipulated in the amended LIA and related Administrative Instructions.

The amendments should address the following issues:

- utilisation of audit sources effectively and efficiently,
- improving the quality of the internal audit assignments,
- licencing and certification of IA together with sustainable solution to maintain the internationally recognised CIPFA certification,
- quality assurance of internal audit work.

4.2.2 Organisational rationalisation of the IA function

The public sector in Kosovo is characterised by high fragmentation. Most of the budget organisations are small in terms of budget, operations, staff, and volume of public services. Nearly each of them has in house an internal auditor or its own IA unit. The overall impression is that the internal audit service is not efficiently used for improving the operations of the BOs. At the same time, there is a number of organisations that run complex processes with high risk exposure and high volume of spending that need larger IA units.

These issues should be addressed in order to benefit from the internal audit by increasing the average size of the units, and providing joint IA service to some small independent budget organisations. By addressing this matter, the issue with positioning Internal Audit Units and salary coefficients will be dealt with.

The role and the necessity of the existence of the Audit Committees should be reconsidered too.

4.2.3 Quality assurance of IA work

There has been substantial accumulation of knowledge and skills for auditing especially due to the very demanding CIPFA certification training. There are methodological guidelines in place and several years of work experience for the internal auditors. Nevertheless at the level of application of the knowledge in individual audit assignments, in strategic and annual planning and risk assessment, the quality of the work needs further improvement in order to comply with the International Standards for Professional Practice of Internal Auditing (ISPPIA).

Analysis and understanding of internal control systems are not at satisfactory level. Communication between internal auditors and managers in the organisations should be further improved. Internal auditors should act as advisors to be helpful to the management in order to benefit from the internal audit function. Therefore, comprehensive quality assurance programme should be developed and elaborated in the coming years.

The CHU IA should be more pro-active in demanding quality and supporting for the improvement of the quality of the work of the IA Units.

4.2.4 Continuing Professional Development for internal auditors

The CPD for internal auditors is a compulsory part of the profession. Training so far has been provided by technical assistance projects. There are different options for providing CPD courses, like on the job training or lecturing and participation in professional events for the internal auditors in Kosovo, in the region or even globally. The CHU IA should develop a plan for CPD, lead in its implementation and take steps for securing financing from the Kosovo budget or other sources.

The opportunities for auditing EU or other donor funds should be anticipated too, in the future, in the CPD programme.

5 Objectives

1. ***Controls over inputs and resources are integrated in the public finance management system and processes by 2017;***
2. ***Managerial accountability on inputs and management of resources in place, verified by dedicated reports prepared by the managers of public funds by 2017 - 2018;***
3. ***Risk management in place in each budget organisation, verifiable by risk management structures and reports by 2017;***
4. ***Internal audit function adds value to the accountable management by providing risk focused assurance and advisory services, verifiable by economy, efficiency and effectiveness indicators by 2019.***

Objective no. 1: Controls over inputs and resources are integrated in the public finance management system and processes by 2017;

In order to address the problem with the adequacy and efficiency of controls and with the risk of violation of rules due to possibility for discretional decisions, the first objective of the PIFC Strategy should be integration and automation of controls in the processes and systems via which the public services are delivered.

The integration of the controls should be supported by institutional building, including strengthening the role of the CHD, establishment of PIFC Council by the Minister of Finance and composed by main stakeholders of PFM reform, such as: Office of the Prime Minister, CHD, Budget, Treasury, Tax and Customs, Ministry of Public Administration, Ministry of Local Government Administration, and representatives from the municipalities. CHD should lead the reform and have strong capacity and adequate skills to support all budgetary organisations in the process of modernisation of the internal control systems. The FMC reform should be supported by adequate legal basis – amending the FMC related provisions in the LPFMA.

The actual integration of controls should be considered as described in the COSO model. Controls are adequate if they are designed to mitigate the risk of non-achievement of the objectives of given activity, process or programme of the organisation. Controls are efficient if they work every time when they have to prevent a threat or provide a warning for a possible threat, malfunctioning, performance deviating from the expected. A major risk in the public sector and PFM processes is the risk of human error or intentional wrong doing. Therefore, controls are considered to be most adequate and efficient when they are an integral part of automated management information systems. The latter does not exclude the risk factor of inefficient decision making and managing. The mitigation of this risk is targeted by the second objective.

Objective no. 2: Managerial accountability on inputs and management of resources in place, verified by dedicated reports prepared by the managers of public funds by 2017 – 2018;

Public sector managers are entrusted with managing public (tax payers) resources with the objective to deliver public services according to the agreed standard. They are expected to give a reckoning on the compliant, economic, efficient and effective management of the public resources. The primary purpose of public spending should not be covering costs, like salaries, cars etc., but paying for delivery of public service. In this respect, public sector managers should be held accountable and report that they have done their best to ensure the public funds are being spend exclusively for the delivery of the public service and the share of overhead, administrative expenses is kept at a reasonable level.

The objective of introducing managerial accountability on inputs and management of public resources addresses the risk of spending on maintaining expensive administration and out-dated structures instead of spending for public growth and development. This is the first phase of the implementation of accountability. The second phase should be related to reporting on outputs and outcomes.

Objective no. 3: Risk management in place in each budget organisation by 2017

The risk in budget organisations and in managing public funds derives from different sources – unpredictable environment, including economy, political factors, lack of experience and capacity of managers and staff, contradicting interests of stakeholders. Therefore, each head of organisation should have risk management structure, plan, actions like risk assessment and risk mitigation in place. Risk management is very closely linked and can be considered as an essential part of the managerial accountability. The absence of risk management, especially in more complex organisations, might cause a failure in implementing governmental programmes, deterioration of public services and in some severe cases (floods, epidemic situations) might be a threat for human lives and safety.

Objective no. 4: Internal audit function adds value to the accountable management by providing risk focused assurance and advisory services, verifiable by economy, efficiency and effectiveness indicators by 2019

The internal audit function is as mature and efficient as the organisation and the management it serves to. Therefore, the achievement of this objective depends entirely on the level of accountability, skills and capacity of the management as they are the client of the internal audit. Internal auditors should help the management in the achievement of the organisational objectives, implementation of programmes and delivering public service.

This objective is for two target groups – managers and internal auditors. The audit reviews should be used by the managers for cost efficient and effective solutions in mitigating the risks and integrating controls in the business processes and systems. The involvement of the internal auditors closes the cycle of improving public finance management and control.

The next phase is the external scrutiny by the Office of the Auditor General which is not subject to this strategy.

6. Recommended actions for Financial Management and Control Development

The establishment of robust and prone to risks integrated controls over public resources requires several actions at the level of the Government, Ministry of Finance as the owner of the PFM system and at the level of each budget organisation.

6.1 Approach recommended for implementation of FMC reform:

Based on the practice of the more advanced countries, the success factors for the FMC are the following:

- Strong political commitment for adherence to the principles of good governance;
- Strong leadership by the CHD;
- Well regulated environment;
- Reliable management information systems;
- Capable and skilled management understanding the objectives of the organisation, able to manage risks, to deliver public service at the agreed standard and to report on what has been achieved;
- Competent CHU FMC able to support the budget organisations with powerful mandate to promote the implementation of FMC;
- Internal and external audit able to provide assurance on the adequacy and efficiency of the control systems.

Over the period of the implementation of the PIFC Strategy, there will be a set of interrelated actions targeting the achievement of the objectives and ensuring that the factors above are in place.

To address these factors:

- Awareness should be raised among the parliamentary committees in charge of public finance, government officials and heads of organizations on the role of the CHU and the benefits of the FMC reform;
- Coordination and collaboration should be in place between the CHU and all other PFM reform stakeholders like Budget Departments, Treasury, Ministry of Public Administration, Ministry of Local Government Administration and others, with special focus on integration of controls;
- The mandate and capacity of the CHU FMC and the trainers – FMC change agents should be strengthened and improved further, not only from professional point of view but also on coordination, communication, and project management;
- Gradual implementation of FMC on pilot basis with committed Heads of Organisations;
- Internal and external auditors trained on FMC requirements, to support the reform.

6.2. Activities related to Objective no. 1

First phase 2015 – 2016:

1. <u>FMC institutional building:</u> establishment by law of PIFC council, to discuss PIFC issues and advice the Minister on the measures for implementing the legal framework and improving the internal control system.

2. <u>Strengthening the role and</u> capacity of the <u>CHD (CHU/FMC),</u> assigning adequate accountability and responsibility for control over inputs and resources to Heads of BOs, Chief Financial Officers, Heads of line departments in charge for programmes and projects.

3. Amendment of LPFMA – covering strategic planning incorporated in the budget cycle, programme budgeting, segregation of duties, sanctions for irregularities, including the respective secondary FMC regulations.

4. Introduction of modified accrual accounting and reporting (commitments, liabilities, assets management) with the obligation for BOs to prepare and submit financial statements. Update and enforcement of relevant accounting methodology.

5. Identification and design of controls - preparation of standard operational procedures, including process descriptions and flow charts with identified controls, such as: budget planning, budget execution, appropriations, commitments, public procurement, management of revenues and expenditures, payments asset and liability management.

Second phase 2016 – 2017:

1. Implementation of controls over inputs, resources, risk management on a pilot basis (5 BOs) for a period equal to budget cycle of 3 years: (i) implementation agreement between CHU, Budget Treasury and BOs; (ii) implementation of the agreed changes in the pilot organisations, monitoring of the results by the CHU FMC.

2. Integration of the controls in the automated financial information systems and integration of the systems from budgeting to auditing *(BDMS/PIP/ KFMIS)*, support to key stakeholders in preparing the related TORs/instructions for IT systems. Close collaboration is needed with all key stakeholders of MoF and other organisations which operate automated information systems.

Indicators: Legal acts amended, ToRs, Instructions, Standard Operation Procedures, FMIS upgraded and integrated**.**

6.3. Activities related to Objective no. 2

First phase 2015 - 2017 whose specific objective is "Introducing managerial accountability on inputs"

1. Amending the LPFMA/regulations on:
   - including requirement that Head of BO should sign the financial statements;
   - introducing a statement on internal control signed by CAO and Head of BO as part of the financial reporting;
   - introducing sanctions for persons in charge for omissions in reporting and not respecting regulations for spending budget resources.
   - introducing requirements for professional qualification for CFOs.

2. Raising the awareness of managers, and senior managers in particular, of the need for improved and extended information systems is essential.

3. Training and capacity development of the financial officer(s) as the key responsible person in supporting managers by providing them with relevant financial information and analysis. T**he role of the CFO will be significant** and their skills will need to be upgraded to enable them to provide the financial advisory expertise necessary to advise managers on both the scope and interpretation of the financial and operational information needed to facilitate the efficient and effective achievement of objectives by managers.

Second phase 2017 - 2018 whose specific objective is “introduction of managerial accountability for outputs and outcomes”

1. Improvement of the legislation to make the managers of programmes responsible and accountable for delivery of services and those objectives are being achieved in accordance with the principles of EEEs and in accordance with plans and programmes.
   - Head of organisation officially authorises the heads of programs to perform the services within the defined budget, defined objectives, outputs and outcomes, establishing also the frequency of reporting to him on the achievement of the above.

2. Helping the managers to identify the specific information (financial and operational) needed to ensure that objectives are being achieved in accordance with the principles of economy, efficiency and effectiveness and in accordance with plans and programmes

3. Training and incentives for managers to take responsibility for achieving their objectives. Examples of incentives include, more discretion to budgetary organization managers over organisational arrangements, greater availability of budget funds where improvements in performance can be demonstrated, greater flexibility to shift funds between budget lines, and less detailed Treasury/Budget control over the details of expenditure. In addition, line managers will need to be trained in the understanding and use of financial information.

4. Improving programme budgeting and reporting with performance indicators (establishing links between strategic planning and budget resources). Managers need to be made aware of the scope of their responsibilities and what they should report upon. Regular reporting is essential for accountability. Reports should cover achievements, performance standards, deficiencies, use of resources and any deviation from what was initially planned.

5. The CHU FMC will roll out the training for all managers of institutions for implementing managerial accountability for outputs /outcomes using experience from pilot BOs.

6. Expanding the functionalities of the KFMIS to provide and process additional financial information (management accounting and costing) to supply information for management reporting on performance budgeting and financial analysis of activity to enable managers to assess efficiency and effectiveness.

Indicators: Legislation Improved, skills of CFOs strengthened, organisational structures approved, number of managers trained; templates of reports improved, KFMIS improved.

6.4. Activities related to Objective no. 3

1. Review of the PFM legal framework for compliance with risk management requirements. The risk management process starts at the same time when the objectives are set and is an integral part of the budget cycle. It includes, (i) Introduction of legal provisions for establishing risk registers, and risk management reporting (ii) alignment of FMC manual with COSO model.

2. Implementation of risk management in line with improvement of internal controls and integration to KFMIS.

3. Capacity building and training for managers to take risk into account when planning the arrangements for the delivery of policy objectives. Management capacity to identify, understand and manage risk will need to be enhanced to enable them to make appropriate managerial decisions. Specific trainings on risk management will be organised by the CHU to enhance management capacity to identify, understand, evaluate and manage risk.

4. Risk management process should be implemented in all pilot BOs by the end of 2019. The CHU will help managers to monitor, mitigate, report and follow up measures in place for risks throughout the budget cycle.

Indicators: Risk registers and reports prepared and approved by management; Risk management priority list presented in MoF; budgeting process and monitoring improved in pilot BOs.

6.5 Monitoring tools

Monitoring will be carried out by the CHU/FMC via FMC Self-assessment questionnaire and on the spot checks. The reports from internal and external auditors will be used to indicate progress and problems of the FMC reform. External ad hoc assessments will be carried out too, such as: PEFA, annual SIGMA reviews, EU progress reports for Kosovo.

6.6 Recommended actions for Internal Audit

6.6.1 Approach recommended for strengthening the IA function:

In order to have professional internal audit in line with the ISPPIA the following factors should be in place:

- Requirements deriving from the ISPPIA should be reflected in the legal provisions, including IA Units, which size and staff are able to deliver in line with the standards, led by qualified / certified IA and internal and external quality assurance checks;
- Professional development programme in terms of training and carrier promotion, monitored by the CHU IA, with appropriate funding allocations;
- FMC requirements for the managers that would make them interested in using the internal audit services.

The progress of the FMC implementation and the professionalization of the external audit reviews will stimulate the need of internal audit services, especially in their advisory part and in a better quality of the internal audit assignments so that organisations get less critics from the external auditors.

6.6.2 Activities related to Objective no. 4

1. Updating the legal framework to ensure compliance with the ISPPIA:
   - Amendment of legal provisions currently included in LIA in order to reflect the organisational changes of CHU/IA as a part of one CHU, update of the criteria for licencing of internal auditors and establishment of Audit Committees;
   - Including IA profession (job positions of internal auditors) in the civil servants' job classification with the respective salary coefficient;
   - Updating the IA Manual.

2. Programme for professional development and carrier promotion: will be regulated by a CHU Administrative Instruction

3. Quality assurance for compliance with the ISPPIA

   - Programmes for QA and improvement developed by each IAU, including internal assessments;
   - Specific actions addressing common issues: training, individual supervision, coaching, mentoring etc.
   - Monitoring of the performance of IAUs based on annual plans by the CHU IA.

6.6.3 Action plan for IA

Year 2015 – 2016

- Amendment of AI or preparation of a new AI for organising and licensing of IA,
- Quality assurance reviews setting priorities in compliance with ISSPIA,
- CPD programme handling the issues of sustainability of CIPFA training,
- Amending the Law on PFMA, incorporating FMC provisions, amending LIA , rationalisation of the internal audit function by decreasing the number of single internal auditor' units and expanding the coverage of the internal audit;
- Introduction of National Internal Audit Certification Programme;
- Improving the quality of the internal audit by implementing the mentoring scheme.

Year 2017 - 2019

- Update of the Internal Audit Manual, expanding the scope of the audits – performance audits, audit of IT systems, system based audits;
- Incorporation of the high risk areas deriving from the risk registry in the annual audit plans;
- Increasing the collaboration of the IAUs with the line managers for selecting high risk areas for auditing and providing valuable advice and recommendations,
- Creating auditing capacities for auditing EU funded /co-funded projects;
- Monitoring of selected IAUs.

Indicators: Amended legislation, OAG's reports for improved reliability on internal audit work, restructured IAUs, number of internal auditors with national certificates.

6.7 Cost- benefit analysis of the overall plan of operations

Type of action	Resources / Cost	Benefits	Cost / Benefit valorisation
Development/improvement of legal framework, procedures and internal rules, etc.	Input of experts work. Eventual donor TA.	Improvement of the control environment, definition of controls ready for integration / automation. Budget savings, Value for money; Eventual EU or other donors budget support if part of conditionality agreement.	Positive - The amount of the budget support
Awareness raising, training, discussions on FMC and IA	Cost of the events, Human resource input, Eventual TA	Developed Human factor - Improved CHD/FMC, Risk management, IA capacity and skills	Budget / TA Cost of events and training compensated by better management, including risk mitigation.
Integration of controls mostly via establishment and automation of MIS	Cost for MIS design, acquisition, maintenance	Timely and reliable information providing for risk management and mitigation, risk controls mitigating most of the risks in PFM and FMIS, job enrichment -work based on technologies	ITS implementation leads to changes in the organisation of work, manual work is taken by ITS and PCs, obsolete jobs, processing, manual operations can be converted in jobs where human presence is irreplaceable – teachers, social workers etc. Savings from jobs and better management offset the investment in IT.
Rationalisation and improved quality of the internal audit function	No additional cost	Better coverage of risky processes and spending, timely, adequate recommendations for risk prevention, less potential for misuse and mismanagement of public funds.	If the IA is focused on high risk area and provides relevant recommendations there is significant potential for savings or getting more (goods, services) for less money.

6.8 Risk mitigation plan

Objective	Risks	Likelihood/ Impact	Mitigation measures	Responsible unit / person
Controls over inputs and resources are integrated in the public finance management system and processes by 2017;	Lack of political support for integration of controls as this means strong financial discipline; Lack of funding for IT – MIS	M/H M/H	Conditions in the Stabilisation Agreement with EU, budget support for implementation Donor funding for upgrade of some MIS	MoF, CHD
Managerial accountability on inputs and management of resources in place, verified by dedicated reports prepared by the managers of public funds by 2017 - 2018;	Insufficient capacity for PFM/Risk management; Lack of control from the MoF/Treasury on reporting	M/M M/M	Conditions in the Stabilisation Agreement with EU, budget support for implementation	MoF, CHD, Treasury
Risk management in place in each budget organisation, verifiable by risk management structures and reports by 2017;	Same as above	Same as above	Same as above	Same as above
Internal audit function adds value to the accountable management by providing risk focused assurance and advisory services, verifiable by economy, efficiency and effectiveness indicators by 2019.	Lack of capacity of some of Heads of IAUs to apply Quality Assurance procedures	M/M	IAU assessment quality procedures	Director of IAU and CHD

7 Responsible stakeholders for the implementation of the PIFC Strategy

The Government of Kosovo shall be responsible for the implementation of the strategy. The Ministry of Finance shall be responsible for the execution of the action plan and shall be the leader of the reform.

At operational level, the CHD shall be in charge for managing and coordinating the actions. The CHD shall act as a secretariat of the PIFC council and Director of CHD shall be a member of the PIFC council.

MoF departments, in particularly Budget, Treasury, IT shall be responsible for taking action and providing the resources for the integration of controls.

The actions deriving from this strategy shall be compulsory for all budget organisations in Kosovo.

8 Action Plan

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
1. Controls over inputs and resources are integrated in the public finance management system and processes by 2017						
1.1. Building institutional capacity	1.1 Presenting the PIFC Strategy – Awareness-raising on the CHU role among politicians, government and other stakeholders.	PIFC conference with ministers, parliamentary committee for budget, donors, other stakeholders	**May 2015**	MoF, CHU supported by the PIFC project in collaboration with EU Office and other donors	PIFC project **10, 000**	EU
	1.2 Legal framework amendments: Amending LPFMA	Approved legislation	**December 2015**	MoF, CHU, Budget Dept., Treasury and other stakeholders	Budget neutral **50,000** PIFC project	EU support needed. Could be the current project to facilitate the discussions and provide advice.
	1.3 Establishment of PIFC Council	PIFC Council established and functional by mid-2016	2016	Minister of Finance	Budget neutral **10,000** from PIFC project	EU support needed (EU, WB, GIZ). Could be the current project to facilitate the discussions and provide advice.
	1.4 CHU/FMC capacity development for training, coordination, communication and managing projects	Training programme and pilot projects managed by CHU staff	2015 2019 through working with pilot BOs	CHU, MoF	Budget neutral **10,000** PIFC project	TA needed for 2015-2019. (EU, WB, GIZ).

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
	1.5 Establishment of FMC training scheme and defining training provider for financial managers, operational managers and internal auditors.	Accredited training provider Records of delivered training	2015	CHU and other key stakeholders – such as Budget Dept., etc.	Budget neutral	TA and equipment needed for establishment of the Centre
	1.6 Applications for donor funding for technical assistance for the PIFC strategy	Applications sent to EU and other donors	2015 and onwards	CHU	Budget neutral	TA support by the existing PIFC project
1.2. Operationalization of control over input and resources	1.7 Amendments of existing legal framework and enforcement of new FMC regulations: - defining the role and segregation of duties between CFO and CO; - Amendments of Treasury rules and regulations in enforcing the ex-ante controls. - modified accrual accounting - strengthening of IC in PP process to prevent the breakdown in smaller lots , - amendment of POEs monitoring procedure and indicators; - amending the FMC manual, - changes in other regulations.	Legal acts and instructions amended or new regulations enforced,	LPFMA 2015 Sublegal acts by end of 2016	Minister of Finance supported by the CHU, Budget Dept., Treasury, MPA, PPA, etc.	Budget neutral **<u>50,000</u>** from PIFC project	TA needed (EU, WB, GIZ)
	1.8. Identification and design of internal controls: process descriptions and flow charts	Process descriptions and flow charts	December 2016	Process owners (Budget, Treasury etc.)	Budget neutral	TA needed

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
	(budget planning, budget execution, public procurement, assets management).					
	1.9 Improvement, design and integration of IT applications (software) to provide adequate internal control in PFM	Financial Management Systems are integrated	In phases depending on resources 2015 - 19	Treasury, Budget Dept., PPA, MED for POEs, etc. Contracted IT company monitored by CHU	Budget neutral **<u>400,000</u>** Annual maintenance	WB and EU can provide financial support <u>Treasury</u>
	1.10 Pilot implementation of control over inputs and resources - 5 BOs, duration 3 years	Reports on pilot implementation from 5 pilot BO (main budget users, central level institutions and 3 municipalities)	2016 – 19	Heads of pilot organisations, CHU, Budget, Treasury, supported by TA	Budget neutral	TA needed.
2. Managerial accountability on inputs and management of resources in place, verified by dedicated reports prepared by the managers of public funds by 2017 – 2018						
First phase 2015-2016 Specific objective "Introducing managerial accountability on inputs"	2.1 (See 1.2 and 1.7 above) Amendments to the LPFMA/regulations on: - including requirement for Ministers, Mayors, Directors of Executive Agencies (Heads of BO) to sign the financial statements; - introducing Internal Control Statement signed by CAO and Head of BO as part of the financial reporting - introducing sanctions for persons in charge for	LPFMA amended, Regulations enforced	December 2015 December 2016	Minister of Finance supported by the CHU.	Budget neutral	See 1.2 and 1.7 above.

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
	omissions in reporting and not respecting regulations for spending budget resources.					
Second phase 2017-2019 specific objective "introduction of managerial accountability for outputs and outcomes"	2.2. Capacity building of senior managers on managerial accountability.	Information published on PIFC website. Number of seminars	2015	CHU staff and trainers	Budget neutral **20,000** from PIFC project	TA needed
	2.3. Trainings for CFOs in FMC arrangements, cost management, financial accounting and reporting.	Number of CFOs trained and certified	2016 on-going	CHU staff and trainers	Costs for 2016 – 2017 shall be covered by TA and from 2018 and onwards will be	TA needed EU, WB, GIZ
	2.4 Improvement of the legislation to make the managers of programmes responsible and accountable for delivery of services and achieving the objectives in accordance with the principles of EEEs. - Head of organisation authorises the heads of programmes to perform the services within the defined budget, objectives, outputs and outcomes. Defining the content and the frequency of reporting on the results.	Accountability provisions in LPFMA, Budget circular and other regulations.	2017	Minister of Finance supported by CHU, Budget Department , Treasury	Budget neutral	TA needed (EU, WB, GIZ)
	2.5 Assisting managers to identify the financial and operational information to ensure that the	Number of programmes with recourses linked to delivery of services in the pilot BOs,	2017	CHU, Heads of Pilot BOs supported by TA project.	Budget neutral	TA needed

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
	delivery of services meets with the objectives.					
	2.6 Improving the programme budgeting and reporting with objectives and performance indicators (strategic planning is linked to budget resources). Reporting on achievements, performance standards, deficiencies and utilisation of resources, deviations.	1. Programme budgeting rules and procedures enforced by MoF; 2. Performance budget execution reports from pilot BOs	2018	Budget Department in collaboration with CHU, Treasury & Programme managers from pilot BOs.	Budget neutral	TA needed
	2.7 Training of managers of all institutions for implementing managerial accountability for outputs /outcomes using experience from pilot BOs	Number of managers trained	2017-2019 and on-going	CHU and trainers and CFO and managers from pilot BOs.		
3. Risk management in place in each budget organisation by 2017.						
	3.1. Review of legal requirements related to risk management - Provisions for establishing risk registers, and taking into account the risks in the MTEF and budget preparation process. - Alignment of FMC manual with COSO model.	1. Pilot BOs possess risk management registers; 2. Risk management process follows MTEF and budget cycle; 3. Updated FMC manual	2015 for budget circular letter containing requirements for risks. September 2016 for pilot BOs assisted by CHU. 2018 of BO	CHU in cooperation with Budget Department, senior management from pilot BOs.	Budget neutral **50,000** from PIFC project	TA needed
	3.2 Risk Identification and evaluation process in line with improvement of internal controls	Risk document prepared by MoF prior to integration and upgrade of the existing IT MIS.	2015 – 2016	MoF, CHU leading the process, supported by other	Budget neutral	PIFC project for selected processes – Budget, Treasury

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
	and integration to Financial Management Information Systems in the public sector.			stakeholders - Budget Department, Treasury, CFOs and other managers from main BOs		
	3.3 Risk management training to identify, understand, evaluate and manage risk	Number of trainings and officers trained in risk management	2016 on- going	CHU and trainers	**10 000** from PIFC project	TA needed (EU, WB, GIZ)
	3.4 Mentoring Heads of programmes/departments in BOs in preparing and approval of risk registers linked to objectives, indicators of MTEF and strategic planning.	Risk registers prepared and approved by head of BOs.	First half of 2016 for pilots. End of 2018 for all other BOs.	CHU and BOs' management supported by TA project	Budget neutral	TA needed
	3.5 Assisting managers to monitor, mitigate, report and follow up measures in place for risks throughout the budget cycle.	Risk register.	First half of 2018	CHU and BOs' management supported by TA project	Budget neutral	TA needed
4. Internal audit function adds value to the accountable management by providing risk focused assurance and advisory services, verifiable by economy, efficiency and effectiveness indicators by 2019						
	4.1. Amending the regulatory framework to ensure compliance of IA with the ISPPIA	Amended LIA New AI on: - criteria for IA - licensing for IA - Audit Committee	2015 Criteria 2016 Licence 2016 Audit committee 2016	CHU	**20,000** from PIFC project. Budget neutral	TA needed
	4.2. Improving the profession of public sector internal auditor	CPD programme – for training scheme for internal auditors: - national certification;	2015 establishment	CHU	Budget neutral	

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
	- establishing the CPD - establishing sustainable training scheme - defining internal auditors positions on the special salary scale (level and coefficients)	- international certification Number of internal auditors trained Legal provisions in relevant regulations enforced	2015-2018 2015-2018 2016	CHU in cooperation with the training provider CHU and MPA		
	4.3 Raising the quality of internal audit work	Recommendations for improvements provided by the CHU based on quality assessments of IA activities carried out in a number of monitored IAUs Methodology for IA work improved (updated IA Manual) Quality assurance program developed and implemented by IAU Increased number of systems & performance audits & IT audits	2015-2019 2015 - 2017 2015-2017 2015-2019	CHU CHU Heads of IAU Heads of IAU	Budget neutral **20,000** for 2015 from PIFC project	
	4.4. Internal Audit function is fully supported by management	Management is involved in the preparation of strategic and annual IA plans (communication evidence – meeting minutes, e-mails, etc.) Number of internal audits planned and performed	2015-2019	Heads of BOs with support of Heads of IA units	Budget neutral	

Objectives	Actions	Performance Indicators	Time frame	Leading Institutions / Supporting institutions	Financial Resources	Funders (KNB, donors)
		increased compared to previous year Number of implemented IA recommendations increased compared to previous year. Measurable benefits of IA work.				
	4.5 Creating capacities for auditing EU funds	Training IAUs from BOs managing EU funds	2015-2019	CHU supported by TA projects	Budget neutral	TA needed

Annex 1: List of documents / References

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3. European Commission: Feasibility Study for a Stabilisation and Association Agreement between the European Union and Kosovo, October 2012
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5. European Commission: Compendium of the Public Internal Control System in the EU Member States, 2012 and second edition 2014
6. Government of the Republic of Kosovo: Declaration of Medium – Term Policy Priorities 2014-2016, April 2013
7. Government of Republic of Kosovo: European Partnership Action Plan 2012, December 2011
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9. Government of the Republic of Kosovo: Policy Paper on Public Internal Financial Control System in Kosovo, April 2011
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14. SIGMA Kosovo (under UNSCR 1244/99) Assessment, May 2011
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19. Law No.03/L-128 On Internal Audit, September 2009
20. Law No.04/L-042 On Public Procurement in Republic of Kosovo, August 2011

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26. Administrative Instruction No.05/2012/MF on Procedure for Professional License Issuance of Internal Auditors of the Public Sector, January 2013
27. Administrative Instruction No.11/2010 on Establishment and Functioning of the Audit Committee in Public Sector Entities
28. Administrative Instruction No.23/2009 on Establishment and Operation of Internal Audit Units in the Public Sector, December 2009
29. Financial Rule No.01/2013/MF – Public Funds Expenditure, May 2013
30. Financial Rule No. 02/2013/MF- On Reporting on Arrears by Budget Organizations, May 2013
31. Regulation MoF – No.02/2013 On Management of Non-Financial Assets by Budget Organizations, November 2013
32. Regulation MoF – No. 03/2013 on Annual Financial Statements of Budget Organizations, December 2013
33. Treasury Financial Rule 01/2010 – Financial Management and Control, July 2010

Annex 2: Comparative analysis of PIFC legal framework in other countries

PIFC legal provisions	Country	Title of Laws
1. PIFC provisions regulated separately from the Organic Budget Act	**Albania**	Law on Financial Management and Control
		Law on Internal Audit in the Public Sector
	BIH	Law on Financial Management and Control *(in the procedure for adoption in Parliament since September 2014)*
		Law on Internal Audit
	Bulgaria	Financial Management and Control Act
		Public Sector Internal Audit Act
	Czech Republic	Financial Control Act
	Croatia	Law on Public Internal Financial Control System
	Lithuania	Law on Internal Control and Internal Audit
	Macedonia	Law on Public Internal Financial Control System
	Montenegro	Law on Public Internal Financial Control System
	Slovakia	Act on Financial Control
2. FMC provisions included in the Organic Budget Act/ Public Finance Act, IA provisions regulated separately	**BIH** *State level*	Law on Financing *(include FMC provisions)*
		Law on Internal Audit
	Cyprus	Law for the Management of Revenues and Expenditures and for the Accounting System *(include FMC provisions)*
		Law on Internal Audit
	Estonia	State Budget Act *(include FMC provisions)*
		Government Act *(include IA provisions)*
	Latvia	Law on the Budget and Financial Management *(include FMC provisions)*
		Law on Internal Audit
	Romania	Law on Public Finance *(include FMC provisions)*
		Law on Public Internal Audit
3. PIFC provisions included in the Organic Budget Act/Public Finance Act	**Hungary**	Public Finance Act
	Poland	Act on Public Finance
	Serbia	Law on Budget System
	Slovenia	Public Finance Act

Source: *SIGMA assessment reports for candidate and potential candidate countries and European Commission Compendium of the Internal Financial Control System in the EU Member States 2012, and second edition 2014*