

2008 Project Fiche Kosovo IPA centralised programme
--

1. Basic information

1.1 CRIS Number:

1.2 Title: PUBLIC FINANCE

1.3 ELARG Statistical code: 01.32

1.4 Location: Kosovo

Implementing arrangements:

1.5 Contracting Authority: The European Commission Liaison Office to Kosovo

1.6 Implementing Agency: The European Commission Liaison Office to Kosovo

1.7 Beneficiary (including details of project manager):

Project activity/component	Beneficiary institution	Contact point responsible for project/activity coordination
1. Support to the Office of the Auditor General of Kosovo to meet EU standards	Office of the Auditor General (OAG) of Kosovo	Mrs Linda Casella Auditor General of Kosovo
2. Support to the process of improving Public Management, Control and Accountability in Kosovo	Office of the Prime Minister of Kosovo; Ministry of Economy & Finance (MEF).	Mr Muharrem Ibrahim Permanent Secretary Ministry of Economy and Finance
3. Improving the quality of public investments in Kosovo and preparing the ground for EU pre-structural funds.	Office of the Prime Minister of Kosovo; Ministry of Economy & Finance (MEF).	Mr Muharrem Ibrahim Permanent Secretary Ministry of Economy and Finance

Financing:

1.8 Overall cost (VAT excluded)¹: €6 million

1.9 EU contribution: €6 million

1.10 Final date for contracting: Three years after the signature of the financing agreement between the European Commission and the Kosovo Authorities.

1.11 Final date for execution of contracts: Two years after the final date for contracting.

1.12 Final date for disbursements: One year after the final date for the execution of contracts.

¹ The total cost of the project should be net of VAT and/or other taxes. Should this not be the case, the amount of VAT and the reasons why it should be considered eligible should be clearly indicated (see Section 7.6)

2. Overall Objective and Project Purpose

2.1 Overall Objective:

Ensure proper stewardship of public funds; transparency and effectiveness in public spending through the improvement of the public financial management system; and the creation of an effective public governance framework in Kosovo.

2.2 Project purpose:

Component 1:

To strengthen the capacity of the Supreme Audit Institution (SAI, which in Kosovo is the Office of the Auditor General) by developing its ability to carry out audits to EU and international standards.

Component 2:

To support the operation of the financial control framework and internal audit systems including the creation of greater awareness and competence amongst senior managers and decision makers in public institutions of the new financial control framework and internal audit systems

Component 3:

To improve the quality of public investment allocation decisions, through further development of the Public Investment Programme and Medium Term Expenditure Framework systems and through capacity building in key Ministries, public institutions and selected municipalities, and thereby also preparing the ground the EU pre-structural funds support and loan financing from IFIs.

2.3 Link with AP/NPAA / EP/ SAA

The proposed project makes reference to the following priorities identified in the European Partnership 2006:

To advance the formulation of a medium term development strategy and plan that is linked to sector strategies, takes into account poverty alleviation, and is aligned with the medium-term expenditure framework and the public investment programme.

To enhance fiscal discipline and better control of public expenditure. To establish effective procedures for the detection, treatment and follow-up of cases of suspected fraud and other irregularities affecting national and international funds.

To develop a public internal financial control strategy as a basis for fulfilling the medium-term recommendations in this area.

European Commission Progress Report 2007

Development of the OAG into a supreme audit institution based on INTOSAI standards and reporting to the assembly will depend on various circumstances. To that end, the OAG needs to draft and implement a strategic development plan.

Regarding financial control and audit the EC report notes that the current internal audit law presents some inconsistencies, mainly in terms of the operational independence of internal audit, which will need to be removed in the future. It also adds that minimum audit capacities have been established in most budget organisations, and managerial accountability and overall auditing capacities need to be reinforced.

The 2006 budget, like the current one [2007], remained on track, as the government remained committed to keeping fiscal policies on a sustainable path. Kosovo has adopted a mid-term expenditure framework 2008-2010 which quantifies its spending needs and defines policy choices and investments in a number of key sectors. However, the prioritisation of key expenditure has not taken place in an orderly way. The difficulties with securing an overall political consensus in order to respect policy commitments were partly due to lack of co-ordination within the government, in particular between the Ministry of Finance and Economy and line ministries during both the strategy definition and implementation phases.

Kosovo Action Plan for the Implementation of the European Partnership

Priority 119, which foresees six specific corresponding actions, aims at strengthening the operational capacity and functional as well as financial independence of the Supreme Audit Institution, the Office of the Auditor General.

A total of six specific actions are included in the Kosovo Action Plan for the Implementation of the European Partnership under priority 75 "Develop a Public Internal Financial Control strategy as a basis for fulfilling the medium term recommendations in this area".

Priority 99 of the Kosovo Action Plan for the Implementation of the European Partnership reads as following: "Advance the formulation of a medium term development strategy and plan that is linked to sector strategies, takes into account poverty alleviation and is aligned with the medium term expenditure framework and the public investment programme". This priority is envisaged to be met with the implementation of seven actions.

2.4 Link with MIPD

Among the socio-economic requirements, the following priorities and objectives are identified:

- Enhancing sound financial management and control at central and local level in order to ensure transparency, efficiency, sustainability and better control of public finances, including development of a modern public procurement framework and related legislation and institutions.
- Improving budget and fiscal policy-making and management, enhancing control and collection capacity of the tax and customs administration and contribute to prudent fiscal policies, including addressing the budgetary and resource implications of EU approximation measures to the budget.

2.5 Link with National Development Plan:

Under MTEF objective 1.1.4 "Public Financial Management" refers to the need to improve budget planning, execution and monitoring to improve resource allocation and spending towards meeting overall government objectives.

2.6 Link with national/ sectoral investment plans:

Under MTEF, objective 1.1.5 "Public Investment Management" envisages as priority that public capital spending together with Private Partnerships are utilised to provide the needed infrastructure for private sector and basic service provision for the public.

3. Description of project

3.1 Background and justification:

Component 1:

The Office of the Auditor General of Kosovo (OAG) was established in 2004 through UNMIK Regulation 2002/18 as an independent public institution. It stipulates that the OAG shall:

- be independent from the Special Representative of the Secretary General (SRSG) and the Provisional Institutions of Self Governance (PISG);
- report to the SRSG; 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;
- prepare a confidential report to the Secretary-General of the UN concerning any information that the SRSG decides to not make public; this report is to be submitted directly to the Secretary-General, together with a copy of the written instruction issued by the SRSG.

The OAG organisational structure includes an Auditor General (international) and a Deputy Auditor General (international), five Audit departments, Administration department, IT department and a Legal office. It has three EU international staff and 87 local staff, including 60 auditors in different stage of training.

By the end of 2007, the OAG will have completed 160 audits throughout various Ministries, Municipalities and Public Owned Enterprises. These audits were predominantly performed by OAG auditors under the supervision of international experts.

The OAG conducts annually a regularity audit of all entities that are either publicly owned or receive funding from dividends or other non-tax revenue to the Kosovo Consolidated Budget (KCB). In addition to regular audits, the OAG may conduct performance audits and provide other services of the kind commonly performed by an external auditor.

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 European Union, through the CARDS programme, has provided consistent support to the OAG. The Strategic Development Plan was endorsed on 24 August 2006 and was developed within the framework of a CARDS project. The Strategic Development Plan covers the period 2006-2012. In 2008 a new technical assistance project funded under CARDS 2006 started aiming at raising professionalism and technical capacity within the OAG.

Component 2:

The project will be a follow up on from two consecutive CARDS projects in public internal financial control and internal audit. These projects have assisted the creation of the new internal audit system and have trained and transferred skills to a considerable number of internal auditors.

The project will address the immediate need of ensuring the meaningful operation of the Central Harmonisation Unit (CHU) for Internal Audit based in the Ministry of Economy & Finance (MEF). The CHU was made operational in 2008 and has replaced the Internal Audit Department (IAD) of the MFE as the body responsible for developing internal audit in the public institutions in Kosovo. Prior to CHU the IAD had helped some public entities and ministries establish minimum capacity to perform their own internal audit function while others were served by the IAD directly. The IAD shall now be confined to performing the internal audit function for the MEF.

The CHU is part of the recently adopted Law on Internal Audit, which is based on the EU Public Internal Financial Control (PIFC) model. The CHU is designed to provide support to internal audit units in the ministries and other budget entities and will no longer carry out any direct internal audits on their behalf. The CHU will have the mandate of continuing the development of the internal audit framework in Kosovo with the aim of establishing effective mechanisms in the foreseeable future.

The Project will:

- Reinforce and further develop the legal framework governing the Financial Management and Control systems;
- Enhance the central role of the Treasury in providing methodological guidance to central and local authorities;
- Enhance awareness on internal control and governance issues, including lines of accountability, risk management, separation of functions, ex-ante and ex-post controls;
- Set up a continuous PIFC training programme for ministers, senior public servants and those responsible for implementing Financial and Management Control systems.

In addition to continuing important technical work of previous CARDS projects, the new intervention will target senior levels in the decision making chain (Ministers, Permanent Secretaries) in order to maximise benefits accrued from these previous projects. The project will focus on enhancing awareness on core topics in public management, public governance, control and accountability for the benefit ministers and senior public servants.

The proposed project is a central theme in all key EC documents, the Kosovo Law on Public Financial Management & Accountability, Internal Audit Law and the Government's strategy for internal audit.

Component 3:

The MTEF process is at embryonic phase in Kosovo. In order to ensure an effective public investment planning framework it is very important that a proper system of forward budget estimates is created and put in operation. The Project will be expected to assist in the design of the overall MTEF system, with special emphasis in the sectors (and related line ministries) that will be targeted for specific assistance under the Project. The PIP is the system (procedure) through which public capital investment projects are proposed, justified, prioritised and inserted in the budget planning process. There is a PIP in place for Kosovo but it shall inevitably require fine tuning and consolidation by the Project. Moreover, the project will be expected to assist in integrating the PIP system with the annual and medium term budget planning in a way that guarantees that there is no parallel process or duplication. The Project is expected to roll out the systems and processes to the operational levels of central and local government. In order to be resource effective the Project will focus at 3 specific sectors and their related line ministries and also to selected municipalities. The annual and medium term budget process (including PIP) can only work effectively if the quality of the budget submissions are rational and serve a strategic purpose. The Project will hence be expected to improve selected sector strategies and link those strategies with budget spending decisions, with particular attention to capital projects.

The European Union has funded two consecutive projects designing and putting in operation the Public Investment Programme (PIP) system. It is expected that after the end of the second project PIP will be operational, in the sense that it will be integrated with the budget process and increase transparency and quality in investment decisions (the capital budget) in Kosovo – outlined in all key EC and government documents. In addition, CARDS has funded a project assisting the Ministry of Transport in strategic planning (“Technical support for implementation of multi-modal transport strategy”).

The proposed project will be designed to consolidate and gain momentum from past gains. It will combine systems development and specific project design and implementation under a single and uniform management system which would work in line with the PISG budget process. On the technical side, the project will improve the PIP system at the aggregate level of the MFE as well as in the specific sectors of the three line ministries/agencies and the selected municipalities. The project will also assist in the establishment of strong medium-term budgeting (i.e. the Medium Term Expenditure Framework) The Agency for European Integration (AEI) will ensure that capacity is created to suit future requirements arising from a possible pre-accession arrangement between Kosovo and the EU.

3.2 Assessment of project impact, catalytic effect, sustainability and cross border impact (where applicable):

Component 1:

A competent and independent supreme audit institution is fundamental to any modern society that is committed to ensuring accountability in the public sector and society as a whole. It is also essential for Kosovo’s closer alignment and possible integration to the EU.

The EU is and will continue to provide substantial assistance to Kosovo. An effective and independent OAG will have a catalytic effect in helping to ensure there is the capacity across government and public institutions to absorb that assistance properly.

Component 2:

Achieving an effective framework for public management, control and accountability requires time, commitment and consistency of action. Technical schemes and regulatory frameworks may be put in place fairly rapidly, but unless there is adequate awareness and understanding by the people involved systems alone shall not guarantee effectiveness.

This project will combine the continuation of the much needed technical work together with the more subtle process of ensuring that top decision makers understand and remain interested in using the systems available.

Component 3:

This project will combine work on improving the overall public financial system with detailed and specific assistance at project design and implementation level. The latter will include efforts to improve the link between policy with public investment decisions, prioritisation of projects. Particular attention will be paid to streamlining reforms within the wider context of the Kosovo budget process, which would ensure realism and sustainability.

The above issues are prerequisites for creating capacity for pre-accession funds from the EU. Equally, if Kosovo can step up efforts to improve the elements required for transparent, efficient and effective public spending other donor organisations and international financial institutions are also expected to provide direct financial assistance.

3.3 Results and measurable indicators:

Component 1:

Result 1: Review and development of the legal framework of the OAG in view of its transformation from UNMIK reserved function to national institution undertaken.

Result 2: Improved administrative and management capacity of the OAG.

Result 3: Further improvement in the audit methodology and audit skills of OAG officials.

Result 4: Improved IT support leading to the introduction of computer-assisted audit techniques.

Corresponding Indicators:

- Drafted legislative amendments, according to EU (chapters 32 & 33 of the *acquis communautaire*) and international (INTOSAI) standards.
- New human resources strategy proposed.
- At least 15 members of staff trained in audit related skills and new techniques.
- New organisational structure in place.

- Reviewed audit methodology & new audit manual prepared.
- IT strategy prepared and computer-assisted audit techniques introduced.
- At least 20 audits using audit software programmes.

Component 2:

Result 1: Operation of the newly established Central Harmonisation Unit for Internal Audit improved.

Result 2: First circle of a certification mechanism for internal auditors developed and carried out.

Result 3a: Benchmark the existing internal control legal framework as compared to International Standards, with a view to updating the existing PIFC Policy Paper with proposed measures to remedy any identifies weaknesses.

Result 3b: Induction course on public management, control and accountability for political appointees (ministers and deputy ministers) and high level public servants developed, in order to build a good governance framework in the Kosovo public service.

Corresponding Indicators:

- Efficient CHU structure in place and management and staff trained.
- Curriculum for internal auditors developed and first cycle of training carried out.
- At least 15 internal auditors trained and certified.
- Number & quality of internal audits carried out.
- Strategy on good governance presented.
- Induction course on public management, control and accountability developed.
- Updated and approved PIFC Policy Paper
- At least 15 training sessions provided.
- At least 15 people trained.

Component 3:

Result 1: Establishment of MTEF process integrated with the overall budget process.

Result 2: Consolidation of the operation of the PIP system integrated with the overall budget process.

Result 3: Improved public investment decisions and quality of project submissions in the budget of 3 specific line ministries/agencies (possible: Ministries of Transport and Environment) and selected municipalities.

Corresponding indicators:

- Legislation drafted for adapting public financial management to medium term budgeting requirements.
- Budget administrative framework redesigned to allow proper medium term budgeting.
- Annual budget circular reviewed to include PIP procedures.
- PIP integrated into BDMS.
- New mechanisms for submission of capital investment proposals established.
- At least 20 people trained on costing and planning of capital projects.

The high level indicator of the project should be increased quality in capital investment project submissions in the 2010 budget process and a reduction in the rate of under-spending during 2010 and 2011 budget execution.

It is important to note however, that detailed and operational measurable indicators can only be developed at project design phase, closer to the time of implementation. This will ensure that the actual situation is appraised and appropriate benchmarks are drawn to demonstrate improvement. Detailed indicators will be included in the terms of reference.

3.4 Activities:

Component 1:

Activities for achieving Result 1

Analyse the existing national legislation relevant to the OAG activities (laws, regulations, rules and procedures), Conduct a comparative assessment of the national legislation against the *acquis communautaire* and INTOSAI standards, Propose amendments to the existing legislation in line with the *acquis communautaire* and best practices from selected EU member states), the Lima Declaration and INTOSAI Auditing Standards.

Activities for achieving Result 2

Elaborate a comprehensive human resources management strategy suitable for the OAG, in view of its post status duties and responsibilities; Building upon the outputs of the relevant CARDS 2006 project, identify training needs, update and improve in-house training programmes and organise training programmes in audit related skills for managers and staff; Advise the OAG on organisational restructuring in order to deliver its activities more effectively, drawing from the examples of other Member States with similar Supreme Audit Institution setup.

Activities for achieving Result 3

Update and improve the audit methodology, manuals and guidelines; provide training on the new audit methodology; Conduct pilot audits to test the new audit methodologies; develop a quality control system according to international standards, in order to ensure continuous improvement of audit methodologies and audit standards and Train the OAG staff in implementing the audit quality control system.

Activities for achieving Result 4

Update and modernise the IT Strategy, including an estimation of the resources required for its implementation (hardware and software); Introduce audit software programmes to assist audits, according to relevant international standards and EU good practices and Train the OAG staff in using the newly introduced software programmes.

Component 2:

Activities for achieving Result 1

Assist in the implementation of the strategy for internal audit; Assist in achieving an optimal organisational and administrative arrangement in CHU and provide on-the-job training and coaching to CHU management and internal auditors.

Activities for achieving Result 2

Development and adoption of an appropriate curriculum with standard courses for internal auditors, drawing from the practice of EU member states and from other international practices; development and adoption of a certification system for internal auditors, drawing from relevant experience from other EU member states, preferably former transition countries and Provide the first circle of training and certification for a number of internal auditors – the precise number to be determined at project design phase.

Activities for achieving Result 3a

Benchmark existing legal environment for FMC against International Standards

Update PIFC Policy Paper to include results of benchmarking exercise including revised Action Plan for the actions to remedy and identified gaps.

Activities for achieving Result 3b

Through dissemination of relevant experience from other EU member states, preferably former transition countries:

Draft a concept paper (or strategy if appropriate) suitable for the development of a good governance framework for the public finances of Kosovo. This concept paper will address ministerial accountability, enhanced annual reporting by ministries, establishment of committee within the Assembly to review the annual reports and the need for legislation to implement all actions conducive to good public governance and Design an induction course on core themes in public management, control accountability (including public finance) for Ministers, Deputy Ministers, Permanent Secretaries and senior public servants and set up a continuous PIFC training Programme.

Component 3:

Activities for achieving Result 1

Provide support to the development of the legal framework for public financial management in a way that is conducive to proper medium term budgeting. This may require, among other things, adjustment in the Law on Public Financial Management & Accountability; Provide support to the development of a suitable budget process and administrative framework in a way that is conducive to proper medium term budgeting. This may require, among other things, improvement in the budget calendar and annual budget circular process and Provide on-the-job training and coaching to MFE, 3 selected line ministries and selected municipalities budget department staff.

Activities for achieving Result 2

Assist in the integration of PIP procedures in the annual budget circular and applied by central (sector planning in line ministries) and municipal budget entities; Assist in the technical and procedural elements necessary to interface and integrate PIP with the management information tool used for all central and municipal government budget submissions the “Budget Development Management System” (BDMS). This should be done in a way that avoids parallel capital investment submissions; Establish proper monitoring system for the implementation of capital projects approved in PIP and Provide on-the-job training and coaching to MFE, 3 selected line ministries and selected municipalities budget department staff,

Activities for achieving Result 3

Assist in developing a mechanism that would guarantee that capital projects proposed are in line with sector policy and specific strategies. This may require review and improvement of sector strategies; Provide guidance that enables compliance with PIP procedures in a way that guarantees that only well justified capital projects are entered into the annual and MTEF budget submissions; Establish clear and transparent systems supporting the public investment selection process and choice of capital projects; Introduce relevant techniques that would improve skills in costing and planning of capital projects; Introduce relevant techniques that would improve capital project management and Provide on-the-job training and coaching.

Contracting Arrangements

Component 1:

The preferred implementation instrument is through Twinning.

The twinning partner(s) will be responsible for delivering all the project results. The ideal twinning team will be led by a Project Leader who will have overall management of the inputs of the member state(s). He/she must have good leadership skills and a broad knowledge of policies and processes in the area of external audit, including the control of EU funds.

The team will include:

- A Resident Twinning Advisor (RTA) with preferably the following profile:
 - Expert in external audit of public funds, with professional background within a SAI from an EU member state.
 - Experience with European and International audit standards and practices.
 - Management skills and/or team leading.
 - Fluency in English and computer skills.
- Short-term experts with experience and competence matching the project components. They should have relevant university degree, professional experience in the relevant field, expertise with on-the-job-training and knowledge transfer, fluency in English, computer skills and ability to work in team. Short-term experts with specific skills in the following areas are likely to be required: audit-related legal issues, audit methodology and INTOSAI standards, audit of EU funds and resources,

audit training, human resource development, information technologies, audit software and computer-assisted audit techniques.

Component 2:

The project will be implemented through two service contracts.

Component 3:

The project will be implemented through a service contract.

3.5 Conditionality and sequencing:

Component 1:

The Government must maintain support for strengthening internal and external audit functions in public administration throughout the duration of the project.

Necessary resources must be provided from the state and adequate staffing of the OAG throughout the project.

Projects to be implemented through twinning require the full commitment and participation of the senior management of the beneficiary institution. In addition to providing the twinning partner with adequate staff and other resources to operate effectively, the senior management must be actively involved in the development and implementation of the policies and institutional change required to deliver the project results.

Component 2:

The Government must maintain support for improving public management and strengthening control and accountability in public administration throughout the duration of the project.

Senior public officials and policy makers (Ministers, Deputy Ministers, Permanent Secretaries and senior civil servants) must be committed and support the implementation of the project by providing input and being willing to follow project activities especially as regards activity 3.

Necessary resources must be provided from the state and adequate staffing of the CHU throughout the project.

Component 3:

The main condition for EC assistance is that the PISG ensures the enforcement of the law on Public Financial Management & Accountability – i.e. the organic budget law of Kosovo. Moreover, PISG and the MEF must make the utmost to remove formal and informal obstacles to proper planning and execution of public investment projects. This included commitment to the operation and consolidation of the PIP system.

At the level of the proposed EU assistance, the PISG is expected to show commitment to the specific objectives of the proposed project and facilitate all those involved in the conduct of their duties.

3.6 Linked activities

Component 1:

The EU has supported the establishment of the OAG and is supporting its further development with the following projects:

- "Support to the Creation and Establishment of a Supreme Audit Institution in Kosovo" under CARDS 2001: this project lasted from May 2003 to October 2006 and assisted in setting up the Office and in its development from the very beginning. An audit support unit, comprising of three long-term audit advisors, was also established.
- "Further support to the Office of the Auditor General" under CARDS 2006: this project started in November 2007 and aims at assisting the implementation of the Strategic Development Plan.

Component 2:

In addition to the CARDS projects aimed at designing and putting in operation Kosovo's internal audit framework (described in section 3.1 above); the EU has assisted in the improvement of the overall public financial system with several projects. CARDS provides on-going support to MEF effort's to put together Kosovo's Public Investment Programme (PIP) and budget formulation framework. Moreover, support was provided to the creation of a modern public procurement system, which shall continue with a project under IPA2007.

The Bretton-Woods institutions are actively engaged in Kosovo. The IMF has a leading oversight role in the development of Kosovo's public financial system. The World Bank has supported public finance management through the on-going project Public Expenditure Management Technical Assistance Grant (PEMTAG). PEMTAG has distinct components supporting financial control through the strengthening of the treasury system of Kosovo.

Other donor involvement consist of sizeable interventions by the US Agency for International Development (USAID) in both the planning and budgeting aspects, as well as budget execution, treasury operation and government accounting. The UK's Department for International Development (DFID) has recently initiated a project aiming to provide a functional review of the entire PISG structure

Component 3:

In addition to the CARDS projects aimed at designing and putting in operation Kosovo's Public Investment Programme (described in section 3.1 above), the EU has assisted the MEF create their standardised budget management information system for the entire Kosovo Consolidated Budget. The system is entitled Budget Development Management System (BDMS).

The area of public expenditure management, in particular public investment, attracts major interest from donors and the Bretton-Woods institutions. The IMF has a leading oversight role in the development of Kosovo's public financial system. The World Bank has actively supported aspects of public finance management through the on-going project Public Expenditure Management Technical Assistance Grant (PEMTAG). The WB has also conducted a very important study on the status of public investment planning and execution in Kosovo. Recommendations from this study have

been taken into consideration in the on-going EAR project which is developing the PIP as well as for this project fiche.

Other donor involvement consist of sizeable interventions by the US Agency for International Development (USAID) in both the planning and budgeting aspects, as well as budget execution, treasury operation and government accounting. The UK's Department for International Development (DFID) has recently initiated a project aiming to provide a functional review of the entire PISG structure.

3.7 Lessons learnt

Component 1:

The OAG is an institution in the making and therefore in need of continuing assistance. As the OAG is a reserved function under UNMIK, the transformation of the OAG into a national institution, following the status settlement, will necessitate appropriate capacity to fulfil the duties of the post-status era. Further assistance will strengthen its management and administrative capacity and will pave the way for transition. It will also assist in the development of the legislative framework necessary for this transition and will support the OAG in order for it to meet EU and international acceptable standards and practice. Skill development and the introduction of modern techniques is part of a process of continuous improvement that shall require time and resources in the years ahead. If OAG is to be effective in its role it should update audit methodologies to EU and international standards. The OAG needs to catch up with other EU and international SAIs, where functional IT tools make up an increasingly important part of the work by facilitating and accelerating audit procedures.

Component 2:

The main lesson learnt thus far is that developing the regulatory framework and providing a critical mass of training and skill development for internal auditors is a necessary but not sufficient condition for the creation of the internal audit system. Internal audit can only function as a part in a wider structure of public governance. The concept of public governance must be endorsed and supported at the highest level of public office if the systems and skills created can be of use.

Component 3:

The main lesson learnt, from the aid delivery perspective, is that even though targeted action may yield considerable benefits it is best if interventions are designed in a strategic manner, possibly under a single project that can optimise management and reduce fragmentation.

Another important lesson is that improving the quality of capital projects cannot happen regardless of the overall capacity for public financial management. Investment planning and prioritising capital projects is an integral part of the budget process, regardless of whether these projects are earmarked for external (donor, IFI etc.) funding or not. Capital investment creates future liabilities which have to be covered by future recurrent expenditure. In order for projects to be viable they must be planned within the wider revenue capacity of a country.

4. Indicative Budget (amounts in EUR million)

			SOURCES OF FUNDING									
			TOTAL EXP.RE	IPA COMMUNITY CONTRIBUTION		NATIONAL CONTRIBUTION					PRIVATE CONTRIBUTION	
ACTIVITIES	IB (1)	INV (1)	EUR (a)=(b)+(c)+(d)	EUR (b)	% (2)	Total EUR (c)=(x)+(y)+(z)	% (2)	Central EUR (x)	Regional/ Local EUR (y)	IFIs EUR (z)	EUR (d)	% (2)
Component 1	x		1.0	1.0	100							
contract 1.1 (Twinning)			1.0	1.0	100							-
Component 2	x		1.5	1.5	100							
contract 2.1 (Service Contract)			0.8	0.8	100							-
Contract 2.2 (Service Contract)			0.7	0.7	100							
Component 3	x		3.5	3.5	100							
Contract 3.1 (Service Contract)			3.5	3.5	100							
TOTAL IB			6.0	6.0	100							
TOTAL INV												
TOTAL PROJECT			6.0	6.0	100							

Note:

- (1) In the Activity row "X" is used to identify whether IB or INV
- (2) Expressed in % of the **Total** Expenditure (column (a))

5. Indicative Implementation Schedule (periods broken down per quarter)

Contracts	Start of Tendering	Signature of contract	Project Completion
Contract 1 (Twinning)	Q4 2008	Q3 2009	Q3 2011
Contract 2 (2 Service Contracts)	Q4 2008	Q2 2009	Q2 2011
Contract 3 (Service Contract)	Q4 2008	Q2 2009	Q2 2011

6. Cross cutting issues (where applicable)

6.1 Equal Opportunity

Equal opportunity will be taken into account in the preparation of all tender documents and in the recruitment of personnel through the placement of appropriate wording.

6.2 Environment

The project is of a purely technical nature of the does not have a direct impact on environment.

6.3 Minorities

Beneficiaries' staff will have to be appropriately sensitised to the principles of fair treatment of minorities in public sector employment policy and practice.

ANNEXES

- 1- Log frame in Standard Format
- 2- Amounts contracted and Disbursed per Quarter over the full duration of Programme
- 3- Description of Institutional Framework
- 4 - Reference to laws, regulations and strategic documents:
- 5- Details per EU funded contract (*) where applicable:

ANNEX 1: Logical framework matrix in standard format

PUBLIC FINANCE		Contracting period: (see section 1.10)	Disbursement period : (see section 1.12)
		Total budget : €6.0 million	IPA budget: €6.0 million
Overall objective	Objectively verifiable indicators	Sources of Verification	
Ensure proper stewardship of public funds; transparency and effectiveness in public spending through the improvement of the public financial management system; and the creation of an effective public governance framework in Kosovo.	<ul style="list-style-type: none"> - Proper and efficient utilisation of public funds and EU funds - Transparency and public confidence 	<ul style="list-style-type: none"> - Screening reports - OAG annual reports - CHU reports 	
Project purpose	Objectively verifiable indicators	Sources of Verification	Assumptions
<p><u>Component 1:</u> To strengthen the capacity of the Supreme Audit Institution (SAI, which in Kosovo is the Office of the Auditor General) by developing its ability to carry out audits to EU and international standards.</p> <p><u>Component 2:</u> To support the operation of the financial control framework and internal audit systems including the creation of greater awareness and competence amongst senior managers and decision makers in public institutions of the new financial control framework and internal audit systems</p> <p><u>Component 3:</u> To improve the quality of public investment allocation decisions, through further development of the Public Investment Programme and Medium Term Expenditure Framework systems and through capacity building in key Ministries, public institutions and selected municipalities, and thereby also preparing the ground the EU pre-structural funds support and loan financing from IFIs.</p>	<ul style="list-style-type: none"> - Quality and scope of the OAG audits. - Review of legislative framework. - Adoption and implementation of international auditing standards and good EU practices. - Effective functioning of CHU. - Quality and scope of internal audit performed by CHU. - Findings of internal audits on accountability, transparency, fiscal discipline and efficiency. - PIP system in place. - Quality and number of capital investment submissions. - Amounts earmarked for capital investment projects. - Reduction of under-spending. 	<ul style="list-style-type: none"> - OAG annual reports. - Texts of laws and secondary legislation. - OAG audit manual. - OAG audit reports on the functioning of CHU. - CHU annual reports. - Independent screening reports and reviews. - Administrative procedures and guidelines for budget preparation. - Kosovo consolidated budget. 	<ul style="list-style-type: none"> - Ability to implement legislation and standards. - Effective split of responsibilities between external and internal audit and MFE - Continued support from the Assembly - Further modernisation of the public sector management and accountability. - Sufficient co-ordination between line ministries. - Continued political support to the reform process.
Results	Objectively verifiable indicators	Sources of Verification	Assumptions
<p><u>Component 1:</u> 1. Review and development of the legal framework of the OAG in view of its transformation from UNMIK reserved function to national institution undertaken.</p> <p>2. Improved administrative and management capacity of the OAG.</p>	<ul style="list-style-type: none"> - Drafted legislative amendments, according to EU (chapters 32 & 33 of the acquis communautaire) and international (INTOSAI) standards. - New human resources strategy proposed. - Staff trained in audit related skills. - New organisational structure in place. 	<ul style="list-style-type: none"> - Text of amendments proposed. - Human resources & employee handbook. - Training assessment forms, materials and reports. - Personnel assessment. - Organigramme of the OAG. 	<ul style="list-style-type: none"> - OAG staff commitment - Political support to reinforce the powers of the OAG. - OAG adequately staffed.

<p>3. Further improvement in the audit methodology and audit skills of OAG officials.</p> <p>4. Improved IT support leading to the introduction of computer-assisted audit techniques.</p> <p><u>Component 2:</u></p> <p>1. Operation of the newly established Central Harmonisation Unit for Internal Audit supported.</p> <p>2. First circle of a certification mechanism for internal auditors developed and carried out;</p> <p>3a: Benchmark the existing internal control legal framework as compared to International Standards, with a view to updating the existing PIFC Policy Paper with proposed measures to remedy any identifies weaknesses</p> <p>3b. Induction course on public management, control and accountability for political appointees (ministers and deputy ministers) and high level public servants developed, in order to build a good governance framework in the Kosovo public service.</p> <p><u>Component 3:</u></p> <p>1. Establishment of MTEF process integrated with the overall budget process.</p> <p>2. Consolidation of the operation of the PIP system integrated with the overall budget process.</p> <p>3. Improved public investment decisions and quality of project submissions in the budget of 3 specific line ministries/agencies (possible: Ministries of Transport and Environment) and selected municipalities.</p>	<ul style="list-style-type: none"> - Reviewed audit methodology & new audit manual prepared. - Staff trained in new techniques. - IT strategy prepared and computer-assisted audit techniques introduced. - Number of audits using audit software programmes. - Efficient CHU structure in place and management and staff trained. - Curriculum for internal auditors developed and first cycle of training carried out. - Number of internal auditors trained and certified. - Number & quality of internal audits carried out. - Updated and approved PIFC Policy Paper - Strategy on good governance presented. - Induction course on public management, control and accountability developed. - Number of training sessions provided. - Number of people trained. - Legislation drafted for adapting public financial management to medium term budgeting requirements. - Budget administrative framework redesigned to allow proper medium term budgeting. - Annual budget circular reviewed to include PIP procedures. - PIP integrated into BDMS - New mechanisms for submission of capital investment proposals established. - Number of people trained on costing and planning of capital projects. 	<ul style="list-style-type: none"> - OAG manual. - Training assessment forms, materials and reports. - Personnel assessment. - OAG annual activity reports. - New IT system installed and used. - Manuals of new software programmes. - OAG annual activity reports. - Organigramme of the MFE and the CHU. - Reports on implementation of the strategy for internal audit. - CHU handbook. - OAG reports on the CHU. - Independent reviews and reports. - Course assessment forms, materials, handouts and reports. - Personnel performance appraisal & assessment reports. - Text and specific goals of the strategy. - Course assessment forms, materials, handouts and reports. - Text of draft legislation. - Administrative manuals and guidelines. - Text of annual budget circular. - BDMS design and manuals. - Kosovo consolidated budget. - Administrative manuals and guidelines. 	<ul style="list-style-type: none"> - CHU adequately staffed and staff committed. - Continued support to public sector modernisation and reform. - Political support to implement the strategy for internal audit. - Senior public officials and policy makers committed to support the implementation of the project. - Continued support for the enforcement of the law on Public Financial Management & Accountability. - Support to proper execution of public investment projects - Commitment of staff involved.
Activities	Means	Costs	Assumptions
Component 1:			

<p>1. Review on national legislation based on international & EU standards</p> <p>2. Elaborate new human resources strategy and organisational structure for OAG.</p> <p>3. Update and improve the audit methodology and establish quality control systems.</p> <p>4. Update and modernise the OAG IT Strategy.</p>	<p>Twinning</p>	<p>€1,0</p>	<p>Member states' relevant institutions interested in establishing a twinning arrangement.</p>
<p>Component 2:</p> <p>1. Assist in the implementation of the strategy for internal audit.</p> <p>2. Development and adoption of a certification system for internal auditors.</p> <p>3. Introduce the concept of a good governance framework for the public finances of Kosovo.</p>	<p>Technical Assistance – Two Service Contracts</p>	<p>€1,5</p>	<p>- Tender procedure carried out smoothly and high quality consultants selected.</p>
<p>Component 3:</p> <p>1. Provide support to the development of proper medium term budgeting and relevant on-the-job training and coaching to MFE and 3 selected line ministries' and selected municipalities' budget department staff.</p> <p>2. Assist in the integration of PIP procedures in the annual budget procedures and applied by central (sector planning in line ministries) and municipal budget entities.</p> <p>3.1 Assist in developing a mechanism that would limit double budgeting.</p>	<p>Technical Assistance – Service Contract</p>	<p>€3,5</p>	<p>- Tender procedure carried out smoothly and high quality consultants selected.</p>

Preconditions:

- Effective split of responsibilities between external and internal audit and MFE;
- Continued support from the Kosovo Assembly to the OAG;
- Further modernisation of the public sector management and accountability;
- Sufficient co-ordination between line ministries;
- Continued political support to the reform process.

ANNEX II: Amounts (in €million) Contracted and disbursed by quarter for the project

Contracted	2009				2010				2011		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Contract 1			1.0								
Contract 2.1 and 2.2		1.5									
Contract 3		3.5									
Cumulated		5.0	6.0								
Disbursed											
Contract 1			0.4	0.083	0.083	0.083	0.083	0.083	0.083	0.1	
Contract 2.1 and 2.2		0.3		0.35		0.35		0.35		0.15	
Contract 3		0.7		0.817		0.817		0.817		0.35	
Cumulated		1.0	1.4	2.65	2.733	3.983	4.066	5.316	5.399	6.0	

ANNEX III: description of the Institutional Framework

The Office of the Auditor General of Kosovo (OAG) was established in 2004 through UNMIK Regulation 2002/18 as an independent public institution. The status of the OAG is defined by the above UNMIK Regulation, according to which the OAG shall:

- be independent from the Special Representative of the Secretary General (SRSG) and the Provisional Institutions of Self Governance (PISG);
- report to the SRSG; 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;
- prepare a confidential report for the Secretary-General of the UN 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.

The OAG organisational structure includes an Auditor General (international) and a Deputy Auditor General (international), five Audit departments, Administration department, IT department and a Legal office. The OAG comprises of three EU international and 87 local staff including 60 auditors in different stage of training.

The Central Harmonisation Unit (CHU) for Internal Audit based in the Ministry of Economy & Finance (MEF) was made operational in 2008 and has replaced the Internal Audit Department (IAD) of the MFE as the body responsible for developing internal audit in the public institutions in Kosovo. Prior to CHU the IAD had helped some public entities and ministries establish minimum capacity to perform their own internal audit function while others were served by the IAD directly. The IAD shall now be confined to performing the internal audit function for the MEF.

The CHU is part of the recently adopted Law on Internal Audit, which is based on the EU Public Internal Financial Control (PIFC) model. The CHU is designed to provide support to internal audit units in the ministries and other budget entities and will no longer carry out any direct internal audits on their behalf. The CHU will have the mandate of continuing the development of the internal audit framework in Kosovo with the aim of establishing effective mechanisms in the foreseeable future.

The responsibility for public financial management in Kosovo is shared between the PISG and UNMIK. The relative importance of the two parties in this power-sharing arrangement has gradually and systematically shifted towards the PISG. The SRSG still has the final authority to set the financial and policy parameters and to approve the Kosovo Consolidated Budget acting on the advice of the Economic and Fiscal Council.

The municipalities are constitutionally separate from the central government but depend heavily on the central government for financing. Their budgets are executed through the same Treasury system as that used for the central government budget organizations.

The legal framework for PFM is provided by Law No. 2003/2, the Law on Public Financial Management and Accountability. The law stipulates among other things that aggregate expenditure ceilings shall be set for the Kosovo Consolidated Budget for three fiscal years, and that these ceilings shall be broken down into sector-specific expenditure ceilings. However, the practice has not expanded beyond the immediate outer year.

Annex IV: Reference to laws, regulations and strategic documents:

Reference list of relevant laws and regulations

- Law on Public Financial Management and Accountability
- Law on Internal Audit
- Regulation 2000/7 on the establishment of the OAG
- Regulation 2002/18 on the status and tasks of the OAG
- Regulation 2001/19 on the Executive Branch of the PISG in Kosovo

Reference to AP /NPAA / EP / SAA

European Partnership 2006

Enhance fiscal discipline and better control of public expenditure. Establish effective procedures for the detection, treatment and follow-up of cases of suspected fraud and other irregularities affecting national and international funds.

Develop a public internal financial control strategy as a basis for fulfilling the medium-term recommendations in this area.

Advance the formulation of a medium term development strategy and plan that is linked to sector strategies, takes into account poverty alleviation and is aligned with the medium-term expenditure framework and the public investment programme.

European Commission Progress Report 2007

The Office of the Auditor General (OAG) is and will remain for the time being a reserved power. The OAG reports on the implementation of the Kosovo Consolidated Budget, including the public utilities, to the Special Representative of the UN Secretary General. Development of the OAG into a supreme audit institution based on INTOSAI standards and reporting to the assembly will depend on various circumstances. To that end, the OAG needs to draft and implement a strategic development plan.

Regarding financial control and audit the EC reports that in September 2007, the government approved the strategy for the functioning of internal auditing in the Kosovo institutions for the period 2008-2012. An internal audit law has been adopted. The law is based on the EU public internal financial control model and provides for the establishment of a central harmonisation unit for internal audit, which will develop standards, train internal auditors, monitor internal audit developments, and provide a quality assurance oversight of internal audit work. The internal audit law presents some inconsistencies, mainly in terms of the operational independence of internal audit, which will need to be removed in the future. However, it is expected that the law will help in clarifying audit responsibilities among stakeholders. The Internal Audit Department in the Ministry for Economy and Finance partly provides the services for the central harmonisation unit (CHU) for internal audit. Minimum audit capacities have been established in most budget organisations, but managerial accountability and overall auditing capacities need to be reinforced.

The 2006 budget, like the current one [2007], remained on track, as the government remained committed to keeping fiscal policies on a sustainable path. Kosovo has adopted a mid-term expenditure framework 2008-2010 which quantifies its spending needs and defines policy

choices and investments in a number of key sectors. However, the prioritisation of key expenditure has not taken place in an orderly way. The difficulties with securing an overall political consensus in order to respect policy commitments were partly due to lack of co-ordination within the government, in particular between the Ministry of Finance and Economy and line ministries during both the strategy definition and implementation phases.

Kosovo Action Plan for the Implementation of the European Partnership

Under Priority 119 - Strengthen the operational capacity and functional as well as financial independence of the Supreme Audit Institution, the actions envisaged include:

- Finalise and adopt a new legal framework for the Supreme Audit Institution in Kosovo, responsible to Parliament and designed in accordance with LIMA declaration and INTOSAI standards.
- Take measures to ensure that the Budget decided by the SRSG/Assembly is to be independent from the organisations the OAG is set to audit.
- Take measures to ensure that OAG shall decide upon its own organisation and salaries to ensure sufficient sustainability and effectiveness.
- Develop a plan/strategy to seek international assistance by SAIs or international audit staff to develop and assist the audit work for the next 3-4 years.
- Develop an audit capacity building strategy that will address training and development of standards, manuals and policies to create a sustainable audit environment within the OAG in order to enable the office to carry out its duties.
- Appoint a National Deputy Audit General to start the transfer to Kosovan leadership of the OAG.

Priority 75 of the Kosovo Action Plan for the Implementation of the European Partnership lists under the title "Develop a Public Internal Financial Control strategy as a basis for fulfilling the medium term recommendations in this area" the following actions:

- Adopt the Public Internal Financial Control Strategy.
- Draft and Adopt the Law on amendment to Law on Public Financial Management (will regulate internal cool and local finances).
- Approve the Law on Internal Auditing in Public Sector.
- Establish the Central Harmonisation Unit for the Internal Audit of Public Finances.
- Establish the Central Harmonisation Unit for Financial Management and Cool System to advise Director of Treasury on further development of internal cool rules.
- Establish a sustainable training facility for training managers, financial officers and internal auditors on PIFC matters; Train 100 internal auditors in accordance with international standards and EU best practices and start implementation in practice.

Priority 99 of the Kosovo Action Plan for the Implementation of the European Partnership reads as following: "Advance the formulation of a medium term development strategy and plan that is linked to sector strategies, takes into account poverty alleviation and is aligned with the medium term expenditure framework and the public investment programme". This priority is envisaged to be met with the implementation of the following actions:

- Draft the standard form (in harmony with EU criteria) for drafting of sectoral strategy which takes into consideration MTEF and PIP.

- Establishment of 22 Working Groups for drafting sectoral strategies.
- Compile first Draft for Sectoral Strategies by the working groups.
- Complete local consultations with local governance and civil society for drafting long-term vision.
- Implementation of Energy Strategy through 3-year program drafted for this purpose.
- Draft a Strategy for the Mining Sector.
- All ethnic communities take part in economic development mechanisms, such as the advisory Group of the private sector, advisory council of small and medium enterprises and the Economic Forum of Kosovo.

Reference to MIPD

Among the socio-economic requirements, the following priorities and objectives are identified:

- Enhancing sound financial management and control at central and local level in order to ensure transparency, efficiency, sustainability and better control of public finances, including development of a modern public procurement framework and related legislation and institutions.
- Improving budget and fiscal policy-making and management, enhancing control and collection capacity of the tax and customs administration and contribute to prudent fiscal policies, including addressing the budgetary and resource implications of EU approximation measures to the budget.

Reference to National Development Plan

Under MTEF objective 1.1.4 "Public Financial Management" refers to the need to improve budget planning, execution and monitoring to improve resource allocation and spending towards meeting overall government objectives.

Reference to national / sectoral investment plans

Under MTEF, objective 1.1.5 "Public Investment Management" envisages as priority that public capital spending together with Private Partnerships are utilised to provide the needed infrastructure for private sector and basic service provision for the public.

ANNEX V: details per EU funded contract (*) where applicable:

Component 1 (twinning):

Tasks under this component included:

- review of the current legislation and preparation of draft amendments in line with the acquis communautaire, selected EU member states best practices and INTOSAI standards.
- preparation of a human resources strategy and a new training strategy, deliver in-house training and present a proposal for organisational restructuring of the OAG.
- produce improved audit methodology, manuals and guidelines, develop an audit quality control system and train the OAG on these outputs.
- modernise the IT strategy and introduce computer assisted audit techniques.

Component 2 (service contract):

The contractor will be expected to:

- assist the implementation of the strategy for internal audit.
- develop a system for internal auditors' certification.
- produce a concept paper for the development of a good governance framework for public finances and an induction course for high level public officials and civil servants.

Component 3 (service contract):

The contractor will be expected to:

- propose legislative amendments and an administrative framework conducting to the development of an MTEF process and integrate it into the overall budget process.
- review the annual budget circular to include PIP procedures and integrate PIP into BDMS.
- establish new mechanisms for submission of capital investment proposals and train the beneficiary's personnel in skills for costing and planning of capital projects.