# Debt Management Performance Assessment (DeMPA)

## Kosovo

## December 2017

WORLD BANK GROUP

The DeMPA is a methodology for assessing public debt management performance through a comprehensive set of indicators spanning the full range of government debt management functions. It is adapted from the Public Expenditure and Financial Accountability (PEFA) framework. The DeMPA tool presents the 14 debt performance indicators along with a scoring methodology. The DeMPA tool is complemented by a guide that provides supplemental information for the use of the indicators.

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For additional information on the World Bank's Debt Management Technical Assistance Program, including more on the DeMPA Tool, please visit our website at: http://www.worldbank.org/debt

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## Glossary

| | |
|---|---|
| BO | Budget Organizations |
| CBK | Central Bank of Kosovo |
| CCC | Cash Coordination Committee |
| CDMD | Cash and Debt Management Department |
| CMD | Cash Management Division |
| CSD | Central Securities Depository System |
| CS-DRMS | Commonwealth Secretariat Debt Recording and Management System |
| DeM | Debt Management |
| DeMPA | Debt Management Performance Assessment |
| DEPPFC | Department for Economic, Public Policies and Financial Cooperation |
| DES | Data Entry Sheet |
| DIFC | Division of International Financial Cooperation |
| DIFK | Deposit Insurance Fund of Kosovo (from the |
| DMD | Debt Management Division |
| DMS | Debt Management Strategy |
| DSA | Debt Sustainability Analysis |
| EBRD | European Bank for Reconstruction and Development |
| EU | European Union |
| EUR | Euro |
| GoK | Government of Kosovo |
| IDA | International Development Agency |
| IFI | International Financial Institutions |
| IMF | International Monetary Fund |
| IT | Information Technology |
| KPSF | Kosovo Pension Savings Fund |
| LPFMA | Law on Public Financial Management and Accountability |
| LIA | Law on International Agreements |
| LPD | Law on Public Debt |
| MTDS | Medium-Term Debt Management Strategy |
| MFA | Ministry of Foreign Affairs |
| MoF | Ministry of Finance |
| NAO | National Audit Office |
| PPG | Public and Publicly Guaranteed |
| SAA | Stabilization Association Agreement |
| SOE | State Owned Enterprises |
| SDR | Special Drawing Rights |
| SDP | State Debt Program |
| T-bill | Treasury Bill |
| T-bond | Treasury Bond |
| TSA | Treasury Single Account |
| USD | United States dollar |
| WB | World Bank |

# 1. Executive Summary

At the request of the Government of Kosovo (GoK), a World Bank (WB) mission[1] visited Kosovo during September 26–October 04, 2017 to conduct a debt management performance assessment (DeMPA). The objectives of the mission were (i) to assess the strengths and areas of development; (ii) to discuss the authorities' immediate needs for TA and follow-up reform plan activities.

This report assesses the debt management performance of the government to manage central government debt by applying the 2015 DeMPA methodology. This is the second evaluation of the government debt performances for the country. The first DeMPA assessment was conducted in 2012. Kosovo also benefitted from a Medium-Term Debt Management Strategy mission in February 2017.

The mission worked with government officials from Cash and Debt Management Department (CDMD) of the Treasury, an agency of Ministry of Finance (MoF), as the main counterparty. Meetings were also held with the Central Bank of Kosovo (CBK), National Audit Office (NAO), Kosovo Pension Savings Fund (KPSF), and three primary dealer banks, as well as with various units of the MoF, including human resources, legal office and internal audit. The mission agenda and the list of officials met during the mission are included in Annex 1.

The main findings of this assessment along the five main areas of the DeMPA methodology are summarized below. Overall, there have been noteworthy improvements in various areas of debt management, including strategy development, domestic borrowing, debt reporting and recording. Challenges mainly arise from staffing constraints, which induce a high level of operational risk.

***Governance and strategy development:***

The legal framework meets minimum requirements for sound practice, however there is room for further improvement such as more explicit reporting requirements. There is need to harmonize relevant clauses in the legislation that governs external borrowing and signing of international treaties. The authorities have launched a project, supported by the World Bank, to have local consultants review the debt management legislation.

The debt management strategy is of high quality. But there is no formal coordination between units that are engaged with external borrowing activities. While the practice of disclosing detailed data on the debt portfolio via quarterly statistical bulletins is impressive, neither the report sent to the Assembly of the Republic of Kosovo, nor the annual report published on the MoF website contains a retrospective description or assessment of debt management operations. External financial and compliance audits of debt management transactions have started since 2012.

***Coordination with macroeconomic policies:***

The MoF has adopted a practice of conducting and disclosing DSAs annually since 2015, using an in-house approach. Projections for debt service are shared with the relevant units. There is no active monetary

[1] The team included Emre Balıbek (Senior Debt Specialist), Ms. Aslı Şenkal (Economist), Mr. Mike Williams (Consultant) and Mr. Michel Vaugeois (Consultant) from the World Bank and Ms. Aurélie Legrand (Project Manager) from United Nations Conference on Trade and Development (UNCTAD). Agim Demukaj (Country Economist) attended key meetings with the authorities.

policy framework as a result of the unilateral adoption of the Euro as the national currency. In line with best practices, direct access of the MoF to CBK lending is prohibited by law.

***Borrowing and related financing activities***:

Although finance has been raised domestically only since 2012, the borrowing processes are well-regulated. The government raises funds from domestic markets entirely through market-based mechanisms, prepares an annual borrowing plan, and publishes a quarterly auction calendar. Borrowing procedures as well as terms and conditions and criteria for access to auctions are publicly available, and there are quarterly meetings with market participants. However, there is room to improve transparency both in primary and secondary markets. Procedures manuals for external borrowing, issuance of guarantees and on-lending are yet to be developed. A standard credit risk assessment and management approach has to be developed following the commencement of guarantee issuance. There is room to accelerate external borrowing processes. which are complicated by the need to comply with legislation that governs international treaties.

***Cash flow forecasting and cash balance management***:

Reasonably reliable monthly aggregate forecasts of cash inflows and outflows and cash balances are produced and updated monthly. The practice of preparing more granular forecasts for the upcoming month, and holding regular meetings with the central bank has been suspended as a result of diminished investment options for the government's cash balances. Under the Stand-By Arrangement with the IMF, Kosovo has a performance criterion to maintain bank balances equivalent to at least 4.5 percent of GDP. The MoF does take its cash flow forecasts into account in planning issuance, with a view to meeting its cash balance target.

***Debt recording and operational risk management:***

Despite competent and dedicated personnel in the DMD, the inadequate number of staff represents a major operational risk: the DMD has only three staff members who act as front, back, and middle office respectively. Regulations do not formally provide for the separation between the different functions in the DMD, and because of staffing constraints, it is very difficult to guarantee an effective segregation of duties. Procedures for debt service, data recording and validation are in place.

Back-up standards for debt data are of high-quality, however a comprehensive business continuity plan for resuming debt management activities is yet to be developed. Debt records are complete, however guarantees records are kept in Excel. The CBK-operated registry system for government securities adheres to sound practice standards.

A detailed assessment of existing strengths and weaknesses in government debt management are included in chapter 4 of this report. In addition, Annex 2 provides a detailed comparison between the current evaluation results and the 2012 DeMPA findings.

In addition to the standard DeMPA evaluations, the authorities also asked the mission to perform a more comprehensive review of the cash management practices at the Kosovo Treasury. In this regard, the mission met with relevant units within the MoF as well as the Tax Administration and Kosovo Customs, i.e. the main revenue collection agencies. Meetings were also held with the Ministry of Infrastructure and the Ministry of Agriculture, Forestry and Rural Development that together represent a significant proportion of government spending in Kosovo. The mission's findings on cash management are summarized in Annex-3.

As requested by the authorities, Annex-4 of the report includes a proposed action plan based on the main findings of the mission, and the priorities for the authorities, regarding areas of improvement in government debt and cash management. The action plan is for the authorities' consideration and does not imply any conditionality on the part of the World Bank. An earlier version of this report has been shared with the authorities, and this version now incorporates their comments.

The team would like to thank the authorities for their excellent collaboration during the visit of the mission, in particular Mr. Ahmet Ismaili, General Director for the Treasury (the Treasurer), Ms. Arijeta Neziraj-Elshani, Deputy Treasurer for CDMD, and their team for their warm hospitality and excellent arrangements; and for all active participation in the discussions. The World Bank stands ready to provide further support in the authorities' endeavor to improve the public debt management function in Kosovo.

## 2. Country Background and Public Debt

### 2.1 Economic Background

Kosovo, the youngest county in Europe, is a lower-middle-income country which has experienced solid economic growth over the last decade. The country declared independence on February 17, 2008 and is recognized as an independent country by 114 out of 193 United Nations members and by 23 out of 28 European Union (EU) members. Kosovo is a potential candidate for EU membership and accelerated its integration process with the signing of the Stabilization Association Agreement (SAA) in October 2015, which entered into force in April 2016.

Albeit from a low base, the Kosovar economy has had a consistently higher growth rate in the post-global financial crisis period than the Western Balkan country average. Growth was driven primarily by households, buoyed by sizable remittances and foreign aid flows and investment. Growth in 2016 was 3.4 percent—one of the highest in the region. Kosovo's GDP per capita grew from USD 1,088 in 2000 to USD 3,661 in 2016. Despite the tripling of income per capita, Kosovo is one of the poorest countries in Europe. The poverty rate (measured as US$ 3.2/day, 2011 PPP) is estimated to have declined to 2.9 percent in 2016, and is expected to continue its downward trend but at a slower rate.

Even though Kosovo's economic growth has outperformed its neighbors and been largely inclusive, this has not been sufficient to reduce the high rates of unemployment; provide formal jobs, particularly for women and youth; or reverse the trend of large-scale emigration. In 2016, the unemployment rate reached 27.5 percent[2], with more than 60 percent of the unemployed still being long-term unemployed, and more than one third being young. Female employment is low at 13 percent.

Kosovo unilaterally uses the Euro as the functional currency and the Central Bank uses macro-prudential policies to support growth. Macroeconomic stability in Kosovo is based on complete euroization, and on fiscal policy that follows a fiscal rule. Kosovo decided to use the Deutsche Mark as its legal tender after the war, and converted to the Euro in 2002. The use of the Euro as domestic currency mitigates convertibility and transfer risk, but it limits flexibility in terms of monetary policy and the Central Bank's function as lender of last resort. Given the lack of independent monetary policy, fiscal policy plays a crucial role in stabilizing the economy.

[2] Per Labor Force Survey 2016

Kosovo has several fiscal rules. The deficit rule sets a budget deficit ceiling of 2 percent of forecast GDP for the general government, and allows for additional financing from international financial institutions (IFIs) for productive investments. The rule ensures that the consolidated cash deficit, excluding spending from privatization revenue plus from revenue carried forward from previous years, does not exceed 2 percent of forecast GDP. Any excess deficit of more than 0.5 percent of GDP must be corrected within the following three years. Privatization proceeds may be utilized to finance capital expenditures above the deficit ceiling only if usable government cash balances exceed 4.5 percent of GDP. The debt law limits consolidated debt to 40 percent of GDP and external borrowing must be ratified by a two-thirds majority in the Assembly of the Republic of Kosovo (i.e. the Assembly). The investment clause introduced in 2015 provides an exception to the deficit ceiling over a ten-year period for productive investment projects financed by development partners including IFIs, provided PPG debt does not exceed 30 percent of GDP. The wage rule, legislated in 2015, is going to be implemented in 2018 and caps the wage increases with the latest available years nominal GDP growth.

While prudent fiscal policy has resulted in low fiscal deficits, challenges remain, particularly with regards to the quality of public spending, and domestic revenue mobilization. Improving the efficiency of public spending and the prioritization of public projects are central to sustaining growth. On the revenue side, a key challenge relates to mobilizing direct taxes and broadening the tax base so as to reduce the country's dependency on customs tariffs, as the latter are projected to decline or at best slow down following the application of the Stabilization and Association Agreement with the EU. The stock of public and publicly guaranteed (PPG) debt is low, estimated at 14.6 percent of GDP in 2016.

The financial sector in Kosovo is healthy and sound. The banking sector dominates the sector and is well capitalized and profitable, with high capital adequacy ratios and low levels of nonperforming loans at 4.9 percent in December 2016. Both credit and deposits have continued to grow at an accelerated rate in recent years. Banking supervision capacity and compliance with international standards is improving, and the non-banking financial sector is also developing.

**Table 1. Kosovo: Key Macroeconomic Indicators (2014-2017)**

| | Actual | | Estimate | Projection |
|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 |
| | (annual percent change) | | | |
| **Real GDP growth, at constant market prices** | 1.2 | 4.1 | 3.4 | 4.3 |
| Private Consumption | 7.8 | 2.9 | 4.2 | 1.9 |
| Government Consumption | 9.8 | 6.7 | -1.7 | 5.5 |
| Gross Fixed Capital Investment | -2.5 | 11.6 | 3.1 | 13.1 |
| Exports, Goods and Services | 7.4 | 1.7 | 5.7 | 6.8 |
| Imports, Goods and Services | 7.5 | 2.6 | 5.0 | 5.6 |
| **Inflation (Consumer Price Index)** | 0.4 | -0.5 | 0.3 | 1.7 |
| **Current Account Balance (percent of GDP)** | -6.9 | -8.6 | -9.2 | -9.6 |
| **Fiscal Balance (percent of GDP)** | -2.6 | -1.8 | -0.9 | -1.5 |
| **Primary Balance (percent of GDP)** | -2.7 | -1.9 | -1.4 | -1.7 |

Source: MoF

## 2.2 Public Debt

The stock of public debt is low, albeit rapidly increasing in recent years, mainly as a result of consecutive primary deficits. The PPG debt was at 14.6 percent of GDP in 2016, the lowest debt level in the Western Balkans, offering room to borrow on concessional terms for productive investments with a high rate of return. The authorities also took steps to introduce government securities in the domestic market, taking advantage of the favorable conditions and with a view on market development. Yet, public debt has doubled since 2012, and strong debt management capacity is needed to keep the rising debt in check.

**Table 2. Kosovo: Total PPG Debt (end-2016), million EUR**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 Q2 |
|---|---|---|---|---|---|---|
| **Total Central Government Debt** | **409.9** | **476.3** | **582.9** | **749.0** | **852.7** | **947.5** |
| **Central Government Foreign Debt** | **336.6** | **323.8** | **326.4** | **371.2** | **373.8** | **443.0** |
| - Direct | 336.5 | 321.7 | 316.5 | 339.9 | 323.9 | 388.4 |
| - On-Lent | 0.1 | 2.0 | 9.8 | 31.3 | 49.8 | 54.6 |
| **Central Government Domestic Debt** | **73.3** | **152.5** | **256.5** | **377.8** | **479.0** | **504.5** |
| **Guaranteed Debt** | - | - | 10.0 | 10.0 | 20.0 | 44.0 |
| **Other Public Debt** | - | - | - | - | - | - |
| **Total** | 409.9 | 476.3 | 592.9 | 759.0 | 872.7 | 991.5 |
| **Total (percent of GDP)** | 8.1 | 8.9 | 10.7 | 13.1 | 14.6 | |

Source: MoF

Slightly less than half of the central government debt is external. In terms of currency exposure, the total share of debt denominated in Euros is around 84 percent of the portfolio (after decomposition of SDR-based debt). 81 percent of the portfolio is fixed rate.

Multilateral debt dominates the external portfolio. As of June 2017, around 46 percent of external debt consisted of loans from the World Bank Group (37 percent from the International Bank for Reconstruction and Development (IBRD)[3] and 9 percent from the International Development Agency (IDA), while the International Monetary Fund (IMF) accounted for 41 percent.

Domestic debt is all market-based. The GoK issues both T-bills (182-day, and 364-day) and T-bonds (2-, 3-, 5-, 7-year). There are 8 primary dealers (PDs) comprising mainly banks, and 1 primary participant – the KPSF. The bulk of the holdings are with the banks (around half of domestic debt), while the CBK and KPSF account for most of the balance.

# 3. Debt Management Performance Assessment (DeMPA)

## 3.1 DeMPA Methodology

The DeMPA comprises of a set of 14 debt performance indicators (DPIs), which encompass the complete spectrum of government debt management operations, as well as the overall environment in which these operations are conducted. While the DeMPA does not specify recommendations on reforms and/or capacity and institution building, the performance indicators do stipulate a minimum level that should be met. Consequently, if the assessment shows that the minimum requirements are not met, this clearly indicates an area requiring attention and priority for reform.

[3] IBRD loans were assumed by the GoK in 2009 as part of debt inherited from the former Yugoslavia.

The DeMPA focuses on central government debt management activities and closely-related functions, such as the issuance of loan guarantees, on-lending, cash flow forecasting, and cash balance management. Thus, the DeMPA does not assess the ability to manage the wider public debt portfolio, including implicit contingent liabilities (such as liabilities of the pension system) or the debt of State Owned Enterprises (SOEs), if these are not guaranteed by the central government. The central government is nonetheless responsible for managing its contingent liabilities and thus for ensuring supervision of public debt and guaranteed public sector debt (which is part of the debt sustainability analysis), which DeMPA evaluates under the following indicators: DPI-1 "Legal Framework," DPI-6 "Coordination with Fiscal Policy," and DPI-10 "Loan Guarantees, On-Lending, and Derivatives."

The DeMPA is largely modeled after the Public Expenditure and Financial Accountability (PEFA) performance Indicators. While the latter covers broad aspects of public financing, the DeMPA focuses exclusively on central government debt management in a greater level of detail compared to PEFA indicators. The points of convergence between these two tools lie in the areas of the recording of cash balances, debt management, and guarantees. There are strong links between PEFA indicators for audit and fiscal planning and DeMPA indicators for audit and coordination with macroeconomic policies.

The scoring methodology assesses each dimension and assigns a score of A, B, or C, based on a list of criteria. If the minimum requirements for a score of C are not met, the dimension is assigned a score of D. A score of C indicates that the minimum requirements considered necessary for effective debt management performance have been met. A score of D, however, indicates that the minimum requirements have not been met and that specific measures are necessary to correct the deficiencies and unsatisfactory performance.

The A score reflects sound practice for the dimension of the performance indicator, corresponding to the best practice level, while a B score is a mid-range score that falls between good practices and the minimum requirements.

In some situations, a dimension is not scored because the activity in the dimension has not actually been carried out (for example, derivatives are not used), in which case the term N/A (not applicable) is assigned to the dimension. The lack of information or even insufficient information makes it difficult or even impossible to assess a dimension, in which case the designation N/R (not rated) is assigned.

When the criteria for a score require that certain legislative provisions, regulations, or procedures be in place, the latter must not only have been approved or signed but must also have been implemented. If that is not the case, these provisions, regulations, or procedures are considered non-existent, and cannot be taken into account in the debt management assessment and thus in the DeMPA scoring. The same principle also applies when the DMS, even if it has been drafted, has not been followed or updated.

## 3.2 Summary of Performance Assessment

| Performance Indicator | | Score 2012 | Score 2017 |
|---|---|---|---|
| DPI-1 | 1. Legal Framework | C | D |
| DPI-2 | 1. Managerial Structure: Borrowing and Debt-Related Transactions | C | D |
| | 2. Managerial Structure: Loan Guarantees | N/R | C |
| DPI-3 | 1. DMS: Quality of Content | D | A |
| | 2. DMS: Decision-Making Process | N/R | A |
| DPI-4 | 1. Debt Reporting and Evaluation: Debt Statistical Bulletin | D | A |
| | 2. Debt Reporting and Evaluation: Reporting to Parliament or Congress | C | D |
| DPI-5 | 1. Audit: Frequency and Comprehensiveness | D | C |
| | 2. Audit: Appropriate Response | N/R | N/R |
| DPI-6 | 1. Fiscal Policy: Provision and Quality of Debt-Service Forecasts | C | D |
| | 2. Fiscal Policy: Availability and Quality of Information on Key Macro Variables and DSA | C | A |
| DPI-7 | 1. Monetary Policy: Clarity of Separation between DeM and Monetary Policy Operations | A | N/A |
| | 2. Monetary Policy: Regularity of Information Sharing | N/R | N/A |
| | 3. Monetary Policy: Limited Access to Central Bank Financing | A | A |
| DPI-8 | 1. Domestic Borrowing: Market-Based Mechanisms and Preparation and Publication of a Borrowing Plan | D | C |
| | 2. Domestic Borrowing: Availability and Quality of Documented Procedures | A | A |
| DPI-9 | 1. External Borrowing: Borrowing Plan and Assessment of Costs and Terms | D | D |
| | 2. External Borrowing: Availability of Documented Procedures | A | D |
| | 3. External Borrowing: Involvement of Legal Advisers | A | A |
| DPI-10 | 1. Loan Guarantees: Availability and Quality of Documented Policies and Procedures | C | D |
| | 2. On-lending: Availability and Quality of Documented Policies and Procedures | D | D |
| | 3. Derivatives: Availability and Quality of Documented Policies and Procedures | N/R | N/A |
| DPI-11 | 1. Effective Cash Flow Forecasting | A | C |
| | 2. Effective Cash Balance Management | C | C |
| DPI-12 | 1. Debt Administration: Availability and Quality of Documented Procedures for Debt Service | C | C |
| | 2. Debt Administration: Availability and Quality of Documented Procedures for Data Recording and Storage | D | C |
| | 3. Data Security: Availability and Quality of Documented Procedures for Data Recording and System and Access Control | C | C |
| | 4. Data Security: Frequency of Back-Ups and Security of Storage | A | A |
| DPI-13 | 1. Segregation of key Staff Duties | D | D |
| | 2. Staff Capacity and Human Resource Management | D | D |
| | 3. Operational Risk Management, Business Continuity, and Disaster Recovery Plans | D | D |
| DPI-14 | 1. Debt Records: Completeness and Timeliness | A | A |
| | 2. Debt Records: Registry System | C | A |

## 4. Performance Indicator Assessment

### 4.1. Governance and Debt Strategy

### DPI-1 Legal Framework

| Dimension | Score |
|---|---|
| 1. Existence, coverage, and content of the legal framework | D |

**Dimension 1**

The legal framework for debt management is defined in the following primary legislations:

- The Constitution dated June 2008,
- The Law on Public Financial Management and Accountability or LPFMA (Law No 03/L-048 dated March 2008)
- The Law on International Agreements or LIA (Law No04/L052) dated November 2011 and
- The Law on Public Debt or LPD (Law No03/L175) dated December 2009

The main secondary legislation is:

- Regulation GRK –No 22/2013 on Procedures for Issuance and Management of State Debts, State Guarantees and Municipal Debts dated September 2013,
- Regulation MoF-CBK No. 01/2014 for the Primary and Secondary Market of Government Securities of the Republic of Kosovo (see DPI8 for details)

The Constitution requires that all international agreements relating to the undertaking of financial obligations of the Republic of Kosovo be ratified (Chapter I, Article 18), and the competency to ratify international agreements is given to the Assembly (Chapter IV, Article 65).

The Law on Public Financial Management and Accountability in Part IX, Article 52 stipulates that the Minister of Finance is the sole authority to:

- Represent the Government in the conduct of its borrowing or guaranteeing activities;
- Conduct all negotiations with all concerned lenders and other third parties on behalf of the Government;
- Execute all loan and/or guarantee documents as the authorized agent of the Government;

The Law on International Agreements gives the power to the President, the Prime Minister, and the Minister of Foreign Affairs to perform all acts related to the conclusion of international agreements (Article 6). Furthermore, the legislation also requires that the Ministry of Foreign Affairs gives its consent prior to negotiating (Article 5) and that the President of the Republic of Kosovo shall authorize the conclusion of international agreements after receiving the consent of the Ministry of Foreign Affairs (Article 7).

The main legislation of debt management (the Law on Public Debt) clearly defines the Minister of Finance as the sole authority to issue domestic debt (Article 7), to sign external loans (Article 11), on-lending agreements (Article 13), and guarantees (Article 19). The legislation also provides the purposes of borrowing (such as to finance State Budget deficit, to finance investment projects that are national priorities, to refinance State debt, to pay for State guarantees, to pay for debt service expenses, or the expenses in case of a national emergency) in Chapter I, Article 3, and requires the Ministry of Finance to elaborate a State Debt Program (SDP) which must include a Debt Management Strategy (DMS) (Chapter IV, Article 15).

The Law also provides borrowing objectives. Chapter IV, Article 15 specifies that the SDP will ensure that the borrowing needs are covered at the lowest possible cost with a reasonable level of risk. Chapter II, Article 7 authorizes the Minister of Finance to develop and facilitate the establishment of primary and secondary market.

Chapter V Article 15 also requires that the SDP be approved by the Government and sent to the National Assembly for information. The SDP must include among other items:

- Statement of the Government's policy goals for its debt
- Debt Management Strategy on how the Government intends to achieve its objectives, and
- Review of previous year's performance and any proposed changes to the DMS
- Evaluation of the previous years' performance and propose any changes to the debt management strategy

However, the most recent SDP did not provide any information on debt management activities. It includes a comparison of actual risk indicators vis-à-vis targets, however this falls short to constitute a complete performance evaluation sincerationale for target(s) that are missed was not included. The SDP did not either cover "historic debt sustainability indicators and projected debt sustainability analysis" as required by the LPD. Information on all borrowing transactions, which were included in the Financial Statements in previous years, was also omitted from the recent report. The annual financial report includes the projected and realized borrowing funds at a consolidated level.

The Law also imposes a debt ceiling that equals to 40 percent of Gross Domestic Product (GDP) (Chapter I, Article 5). The legislation designates the Central Bank of Kosovo (CBK) (Chapter VI, Article 16) as the fiscal agent.

The Regulation GRK –No 22/2013 on Procedures for Issuance and Management of State Debts, State Guarantees and Municipal Debts describe the process of contracting external debt, guarantees and municipal debt.

Lastly, the Law on the Central Bank of Kosovo (CBK) (Law No03/L-209) dated July 2010 stipulates that it may act as the banker, financial advisor and fiscal agent for the Government (Chapter XI, Article 29).

Although the various legislations clearly designate a sole authority (the Minister of Finance) to sign all contractual agreements, and the Law on Public Debt defines the purposes of borrowing, the Public Debt Law was not fully implemented (e.g. clauses of LPD Article 15). Thus, the minimum requirements for this indicator are not met under the methodology and is rated D[4]. The rating differs from the 2012 DeMPA, as the State Debt Program does not fully comply with the requirements of the Public Debt Law.

[4] 2015 DeMPA methodology requires that legislation is fully followed to be assessed for the minimum requirements.

## DPI-2 Managerial Structure

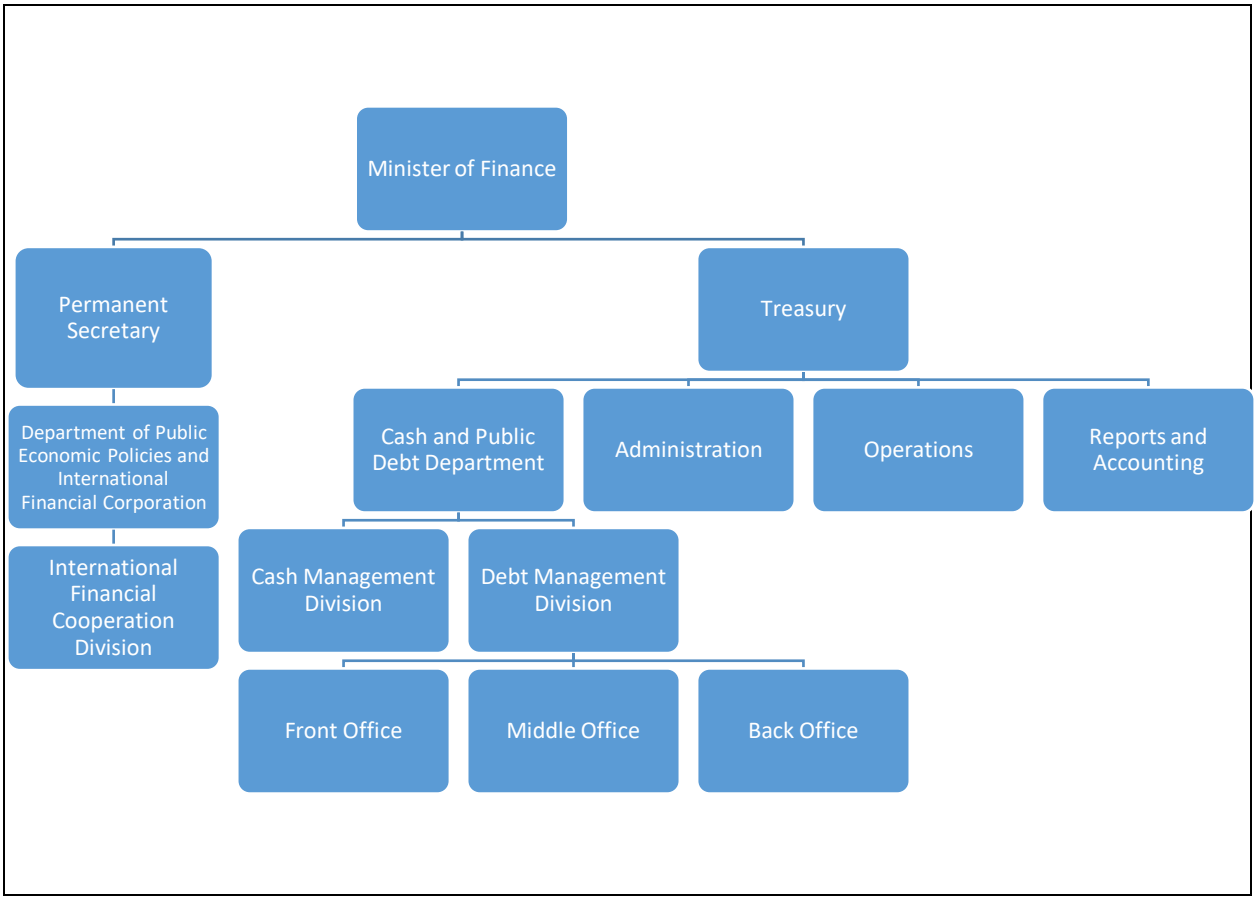
| Dimensions | Score |
|---|---|
| 1. The managerial structure for central government borrowings and debt-related transactions. | D |
| 2. The managerial structure for preparation and issuance of central government loan guarantees. | C |

### Dimension 1

The debt management structure of the Republic of Kosovo has changed since the previous assessment. Currently there are two entities responsible for debt management (see Chart below):

- The Treasury through the Debt Management Division (DMD) of the Cash and Debt Management Department (CDMD), and
- The Division of the International Financial Cooperation (DIFC) of the Department of Economic, Public Policies and International Financial Cooperation (DEPPFC).

**Figure 1. Kosovo: Organizational Chart for Debt Management**



The DIFC is responsible for the Front Office for most part of external borrowings. Its functions are described in the Regulation GRK No: 06/2014 on Internal Organization and Systematization of the Ministry of Finance. The main responsibilities are:

- To follow up at the state level with bilateral organizations and cooperation with international financial organizations and other international organizations in economic and financial fields.
- To cooperate with the International Monetary Fund (IMF), World Bank (WB), European Bank for Reconstruction and Development Bank (EBRD), European Investment Bank (EIB), and other bilateral financial institutions.
- To lead or participate in negotiations and report on negotiations with the above-mentioned institutions and governments on the conclusion of the agreements.
- To maintain a database on the detailed information in terms of international cooperation with the above-mentioned institutions.

The DMD is the Front Office for domestic debt and some external borrowing (see below). Middle and Back Office functions (for both external and domestic debt) are also performed by the unit. Its responsibilities are defined in the Regulation (GRK) No: 06/2014 for Internal Organization and Systematization of Job Positions within the Kosovo Treasury. The main duties are to:

- Develop a suitable management environment in accordance with long-term parameters for public debt
- Implement financial strategies that minimize cost and risk of debt management
- Assess financing alternatives and their impact in relation to adherence to current laws and regulations.
- Issue securities in accordance with the Strategy, the Budget Law, and development of financial markets
- Provide adequate information on the issuance of domestic debt to donors, investors, financial institutions and commercial banks
- Prepare cost and risk analysis for all investments and warranties before the approval phase
- Prepare the State Debt Program
- Prepare requests for appropriation for debt service and requirements for funding during the Budget review
- File and maintain all documents related to state debt
- Participate as a member of the negotiating team
- Monitor the technical implementation of financial agreements, including disbursement deadlines and execution of various payments and fees on loan repayments

Currently, the functions of the Front Office for external debt have been divided, based on an e-mail from the Minister of Finance, between the two units. The DIFC has the lead with all the international financial organizations and bilateral creditors, with the exceptions of the World Bank and two bilateral creditors (France and Hungary) which are handled by the DMD. Both units are members of the negotiating team. However, a negotiation team is not a formal coordination mechanism as team members can be changed (depending, for example, on the beneficiaries) and there are no official terms of reference for the team that define their responsibilities.

The DMD also coordinates closely with the Department of Public Economic Policies and Budget Department, as well as with the CBK. However, there is no formal coordination mechanism.

The Regulation GRK No: 06/2014 mentions only that the CDMD be divided in two units: Cash Management Division (CMD) and DMD, with a Head of Division for DMD, reporting to the Deputy Director of Cash and Debt. However, internally, the functions have been divided into a front, middle and back office based on the terms of reference of the (currently three) staff (see Figure 2). However, this structure is not yet formalized as it is not reflected in the Regulation.

As the main front office activities are managed by two units without a formal coordination mechanism and without a regular exchange of information, the minimum requirements for this first dimension are not met and it is scored D. The rating is lower than in the first DeMPA as all the debt management functions were then within one entity in the same institution; as the DFIC had not been created.

**Dimension 2**

As per the Law on Public Debt, the MoF is responsible for issuing guarantees (Chapter VII. Article 19), after authorization from the Government (Article 21). As per Regulation 22/2013 (Article 8), the Minister of Finance establishes a team called "Team for Review of Application for Guarantees". The Article requires the team to include at least the Department of Budget, the Department of Economic and Public Policies, and the Treasury. The Ministry of Foreign Affairs and the Legal Department of the MoF are also members of the team. The Article also defines the task of the team, which is to provide recommendations to the Minister of Finance and to set the tariff (guarantee fee) to comply with the Law cited above. Regulation 06/2014 stipulates that the Debt Management Division is responsible for "carrying out risk and cost analysis for all investments and warranties". The Law on Public Debt provides the general policy framework for issuing guarantees (see DPI-10-1 for details).

As discussed in DPI-10, the Regulations describe the process of issuing guarantees only partially. Under current practice, the DMD functions as the main entity responsible for guarantees, and coordinates administrative work. Regulation 06/2014 does not cite management of guarantees explicitly within Treasury or DMD functions, apart from cost-risk analysis. The review team does not have terms of reference that detail its responsibilities. Therefore, the roles of different units and the decision-making structure in the team are not clear.

Although the DMD coordinates the guarantee issuance process, as the main entity ensuring information flows within the review team; a clear guarantee framework that fully describes the process does not exist. Therefore, this dimension is rated as C. In the previous DeMPA, this dimension was not rated because no guarantee had been issued.

## DPI-3 –Debt Management Strategy

| Dimensions | Score |
|---|---|
| 1. The quality of the DeM strategy document | A |
| 2. The decision-making process and publication of the DeM strategy | A |

**Dimension 1**

As described in DPI-1, Article 15 of the LPD requires the MoF to prepare annually the SDP that includes a DMS. According to the Law, the Ministry has to prepare a debt management and borrowing strategy that is consistent with the macroeconomic and fiscal framework as laid out in the Medium-Term Expenditure Framework (MTEF) to ensure a sustainable debt position. The Article also stipulates that the SDP should include standards and targets, including specific annual debt limitations for each category of international and domestic debt, i.e. the strategic benchmarks. The document should also describe how the Ministry will implement the program and achieve these targets. The government has approved and published five SDPs so far: in November 2012 for 2013, in December 2013 for 2014-2017, in April 2015 for 2016-2018, in April 2016 for 2017-2019, and in April 2017 for 2018-2020.

The latest SDP, published in April 2017, follows the Medium-Term Debt Management Strategy (MTDS) framework developed by the World Bank and the International Monetary Fund. The document states the government's main debt management objective as "to ensure the financing of the budget deficit with the lowest cost possible always considering the acceptable levels of exposure to financial risks". The SDP also cites the core principles in achieving this objective which emphasize financing in accordance with the Annual Budget and LPFMA; the risk limits; transparency in borrowing operations; and focusing on long-term development of the market instead of possible short-term benefits.

Although the SDP is titled for 2018-2020, it clearly states that the period covered is 2017-2020. The scope is defined as "State Debt", which according to LPD is "debt incurred on behalf of the Central Governmental Institutions that the Republic of Kosovo is obligated to pay". This includes domestic and foreign debt of the central government. The SDP contains a detailed analysis for strategy selection. This begins with an analysis of the cost and risk indicators of the current portfolio; and includes discussion on domestic and external financing sources. Possible alternative strategies are described and evaluated under various market scenarios[5]. Based on the analysis the document identifies a certain strategy and includes risk targets for the portfolio composition. The current targets for the central government portfolio include:

**Table 3. Kosovo: Risk Limits set for 2017-2020**

| Risk | Limit |
|---|---|
| Currency Risk | • No more than 30 percent of total debt stock may be in foreign currencies[6] |
| Interest Rate Risk | • No more than 30 percent of total debt stock may have variable interest rate |
| Refinancing Risk | • Domestic debt maturing in one year should be less than 50 percent of the total<br>• The average time to maturity of domestic debt should be longer than one year |

Source: SDP, 2018-2020

The government has adopted a practice of publishing and updating debt management strategies since 2013. The recent strategy contains targets for risk indicators, based on a detailed analysis. Therefore,

[5] While the MTDS analysis in the SDP is noteworthy, in general the strategy document that is publicly disclosed does not necessarily include the detailed analysis and assumptions behind the analysis – this information can be internal and confidential. The steps for the MTDS analysis are generally documented internally to facilitate discussion among relevant parties within the government, and to help the authorities formulate, adjust, and ultimately implement their strategy. Once a decision is reached, the DMS outlines the strategy to be implemented.

[6] Currencies allowed are USD, GBP, JPY, and any other currency which is linked to these currencies or whose fluctuations in relation these currencies have not exceeded 5 percent, on average, in the last 5 years,

the dimension is rated as A. There did not exist a document compliant with the requirements of this dimension in 2012.

**Dimension 2**

Article 15 of the LPD briefly describes the strategy development process. Accordingly, the MoF has to prepare and submit the SDP for approval, which is then shared with the Assembly for information. The Regulation (GRK) No: 06/2014 for Internal Organization and Systematization of Job Positions within Kosovo Treasury then stipulates (in Articles 7 and 9) that the DMD within the CDMD has to prepare the SDP.

The DMD initiates the SDP preparation process in accordance with the process for the preparation of the MTEF. According to Article 19 of the LFMA, the government has to submit the MTEF for the next fiscal year and the following two years to the Parliament no later than April 30. The DMD has also adopted the practice of publishing the SPDs in April. Article 15 of LDP stipulates that the SDP should be published before no later than end-December in harmony with the METF, while the LFMA requires the MTEF to be published in April. The DMD has adopted the practice of publishing SDPs in April. This also covers the strategy for the current year. The CBK's opinion is obtained during the process.

The annual borrowing plan prepared (but not published) at end-December or early January is consistent with the SPD published in the preceding April. As there have not been major revisions in the targets in recent years, this is generally also consistent with the SPD published in the succeeding April.

Despite some conflict in the interpretation of related laws[7], as the strategy is formally approved and published in line with MTEF targets, the CBK's views are obtained, and the annual plan is in line with the strategy, this dimension is rated A. This dimension was not rated in 2012.

## DPI-4 Evaluation of Debt Management Operations

| Dimensions | Score |
|---|---|
| 1. Quality and timeliness of the publication of a debt statistical bulletin (or its equivalent) covering central government debt, loan guarantees, and debt-related operations. | A |
| 2. The presentation and content of an annual evaluation report to the parliament or congress on DeM activities and general performance. | D |

**Dimension 1**

A quarterly debt statistical bulletin as well as an annual one is published on the MoF's website. The quarterly report contains information for total as well as domestic and external debt; and information on state guarantees. Data published include total debt by currency and interest type; outstanding volume, disbursements and payments by creditors for external debt; international loan agreements signed; and outstanding volume by instruments, securities issued, and debt by holders for domestic debt. The quarterly report also includes a table for cost and risk indicators of the portfolio. Indicators covered

[7] The requirement of publishing the SDP before end-December could be interpreted as the requirement for a strategy to be implemented as of next January, as is the usual case in many countries. The DMD could possibly publish the SDP for the following period in December based on the latest budget figures for the next year, and the MTEF of the preceding April, and make a consistency check in the following April or June after the mid-year budget review.

include: weighted average interest rate, average-time-to-maturity for external and domestic debt, and currency composition. The bulletins are published at the end of the following month after the end of the quarter (i.e. in April for Quarter 1, in July for Quarter 2)

As a debt statistical bulletin with main risk indicators of the portfolio is published within a month, this dimension is rated as A. The bulletin did not exist in 2012.

**Dimension 2**

The only document regarding debt management that is sent to the Assembly is the SDP. Paragraph 1 of Article 15 of the LPD stipulates that a section of the SDP should be dedicated to evaluating the previous year's functioning in relation to settled standards and objectives. Paragraph 2 cites the following to be included in the report:

- data on historic state debt and current outstanding part and state guarantees
- expected payments on guarantees;
- historic and current debt service for all state debt;
- proposed state debt and state guarantees, including the purposes of such debt;
- projections of debt service including proposed future debt;
- historic debt sustainability indicators and projected debt sustainability analysis; and
- review of previous year's performance and any proposed changes to the SDP.

The latest SDP, published and sent in April 2017, follows the format of an MTDS analysis report, and has a forward-looking content, with targets and projections. It does not, however include retrospective analysis and data, as required in the LPD. Some of the required information is contained in the Annual Bulletin on Public debt, which is published on the MoF website, but not sent to the Assembly. The annual bulletin contains retrospective debt data, but does not either include discussion of debt management activities or evaluation of operations with respect to targets. The annual financial report includes the projected and realized borrowing funds at a consolidated level.

The minimum requirements for this dimension are not met, and the dimension is rated as D. This dimension was rated as C in 2012 as the 2012 Annual Debt Strategy document did describe main DeM activities undertaken during the year by the central government (even though very few activities were executed). The rating for this dimension can easily improve by enhancing the annual bulletin and by adding it to the SDP as an annex.

## DPI-5 Audit

| Dimensions | Score |
|---|---|
| 1. Frequency of financial audits, compliance audits, and performance audits of the central government as well as publication of the external audit reports | C |
| 2. Degree of commitment to address the outcomes from internal and external audits | N/R |

**Dimension 1**

The Constitution of the Republic of Kosovo sets the framework for the Auditor General of Kosovo to act (Articles 137 and 138), including on auditing the use and safeguarding of public funds by central and local authorities.

The National Audit Office is the institution responsible for external audit in Kosovo and is specifically regulated by Law 05/L-055 adopted in May 2016 on the "Auditor General and the National Audit Office (NAO) of the Republic of Kosovo" which sets the scope for external audit of public funds, budget execution, and use and governance of publicly-owned resources. Article 18 specifies the mandate of the NAO, including the handling of all public money and the right to audit any time loans, credits and liabilities guaranteed by public sector entities. The law also defines the types of audit the NAO can undertake[8]. In addition, the LPFMA covers external audit in its Part VIII, Chapter 2.

The NAO is a constitutionally independent institution, and it prepares yearly financial audit reports that are presented to the Assembly. The NAO conducts compliance and performance audits of institutions named in the Law 03/L-075[9]. However, no obligation for the timing of performance audit is set and it is left at discretion of the NAO.

Considering the importance of debt, the NAO would like to pursue a debt management performance audit. However, it has limited technical capacity within the team to undertake such an audit and only performs financial and compliance audits of debt operations. Public debt is treated within the regularity audit of entities that have contracted public debt and these reports are published yearly by 30 June.

External financial audit of debt data is conducted on an annual basis and the audit report is published within 6 months. In addition, the NAO conducts compliance audits to ensure that the external borrowing processes are in line with the prescriptions of the law. The NAO sends its first draft report by 30 July to ministries which have 15 days to comment on the findings. The final report is published no later than 30 August. For example, in its 2016 Annual Report, the NAO made recommendations on the presentation of debt data to include "detailed information on the domestic and international debt stock, the debt balance by creditors, financial instruments should be presented".[10]

The LPFMA accountability provisions require every budget organization, autonomous executive agency and public undertaking to comply with all applicable requirements of the Law on Internal Audit n°03/L-128, including establishing an Internal audit unit[11]. The management of audit activities of the MoF and the processes are detailed in two procedures manuals[12]. According to the “MoF Internal Audit Manual Volume 1”, the internal auditor is responsible for evaluating the processes of controlling operations throughout the organization based on an assessment of the adequacy of the internal control systems. The MoF has four audit units: one each for the Tax administration, for Customs, for the MoF, and for Treasury.

[8] See Law 05/L-055, Article 21. Types of Audits

[9] Article 3.2 of the Law specify that "The Auditor-General shall annually conduct a Regularity Audit of the Kosovo Consolidated Budget, budget organizations, including but not limited to the Assembly of the Republic of Kosovo, the Office of the President of the Republic of Kosovo, each Ministry and executive agency, municipalities, independent bodies, the Central Bank of the Republic of Kosovo (CBK), and other entities that are either more than 50 % publicly owned or receive funding from, or provide dividends or other non-tax revenue to, the Kosovo Consolidated Fund including but not limited the Kosovo Customs Service, the Kosovo Privatization Agency and the Ombudsperson."

[10] Annual Audit Report 2016, Republic of Kosovo National Audit Office, p.28.

[11] Internal audit provisions in Part II, Chapter 2, Article 11 of law No. 03/L-048

[12] Source: http://mf.rks-gov.net/page.aspx?id=2,79

The internal audit process in Treasury is based on an annual audit plan which includes debt management. This plan is approved by the Treasurer and the Audit Committee of the MoF. The primary goal is to audit the functioning of internal controls in the MoF.

For the period July 2016-June 2017, the internal auditor has focused its audit on the segregation of duties in the DMD in relation to the usage of the debt database, i.e. the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) in terms of access rights, back-up policies, etc. He audited the procedures and controls in line with job descriptions, access rights policies, and IT procedures.

Payment of debt service was also audited. The internal auditor requested that all the bills and legal agreements related to debt service operations (both external and domestic) were reconciled with data in the CS-DRMS and the Financial Management Information System (KFMIS). The internal auditor recommended that this type of audit should be conducted yearly in future.

The internal auditor of the Treasury is limited to the audit of Treasury activities, and hence could not undertake a comprehensive audit of debt management activities that involve different ministries and entities. Furthermore, considering the specificity of debt management, the internal audit unit has limited competence in debt management operations to conduct a performance audit of DMD operations.

This dimension is scored C as external financial and compliance audits of DeM transactions are conducted annually by the internal and external auditors. To obtain a higher score a regular performance audit of debt management activities would be required. This dimension was rated as D in 2012 as there was no comprehensive audit of debt management activities.

**Dimension 2**

The law 05/L-055 prescribes that the NAO should follow-up on the implementation of recommendations throughout the year, and procedures are set for this purpose[13]. It also prescribes the timeframe for producing a response. Based on the recommendations of the final audit report, ministries have 30 days to present their action plan to the NAO which should include a time table for the actions and identify the person in charge of implementing it. The NAO follows-up on the implementation of the recommendations in its next Annual report. At the time of the mission, the authorities were in the process of preparing their first ever action plan to respond to NAO comments in the 2016 report. Action plans were not prepared in the previous years, as there were no specific recommendations.

At the level of internal audit, the internal auditor confirmed to the mission that the DMD is active in following-up on the recommendations and has implemented measures to improve information systems testing and back-up policies for the database. He confirmed that the DMD has always been active in producing a response to the recommendations and has implemented corrective measures.

This dimension was not rated in 2012 since no audit of government debt management operations had been conducted. In 2017, the dimension is again not rated (N/R) since the response to NAO's comments was under preparation, and could not be evaluated by the mission.

[13] See Articles 21.2. and 23.5 of Law 05/L-055.

## 4.2 Coordination with Macroeconomic Policies

### DPI 6 - Coordination with Fiscal Policy

| Dimensions | Score |
|---|---|
| 1. Support of fiscal policy makers through the provision of accurate and timely forecasts on total central government debt service under different scenarios | D |
| 2. Availability of key macro variables, an analysis of debt sustainability, and the frequency with which it is undertaken | A |

**Dimension1**

As part of the processes for the yearly preparation and review of the State of Kosovo's annual budget, the DMD prepares projections of the total debt service of the central government, and shares them with Budget Department. Projections for the next three years are also provided to the DEPPFC that is in charge of preparing the MTEF. Accordingly, the MTEF included three year projections for interest and principal payments.

As stated earlier, around 84 percent of the debt portfolio is denominated in EUR, after decomposition of SDR-based debt, and 81 percent of outstanding debt is fixed rate. In preparing the projections, the DMD conducts sensitivity analysis for the SDR-denominated and variable rate parts of the government's debt portfolio. Scenario analysis with regard to possible downturns in the macro and market environment is not conducted. However, the budget appropriations include a buffer for interest payments based on sensitivity analysis.

The discrepancies between forecast and actual debt service over the past three years are given in Table 4. In the period 2014-2016, interest payments were generally over-estimated in the budget as a result of the added buffers and the declining interest rates consequent on excess liquidity. The budget projections for principal payments were more accurate.

**Table 4. Kosovo: Projections and Actual Figures for Debt Service (2014-2016), EUR**

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| Budgeted | | | |
| - Principal | 22,100,000 | 27,212,274 | 66,522,506 |
| - Interest | 16,500,000 | 17,438,906 | 24,750,000 |
| Actual | | | |
| - Principal | 22,049,134 | 28,872,226 | 65,991,763 |
| - Interest | 12,827,002 | 16,006,267 | 19,206,936 |
| Discrepancy | | | |
| - Principal (percent) | -0.2 | 6.1 | -0.8 |
| - Interest (percent) | -22.3 | -8.2 | -22.4 |

Source: MoF

Even though the projections provided by the DMD during the budget preparation process included sensitivity analysis; large buffers on interest payments in the budget and market developments led to

deviations between forecasts and actual figures[14]. Therefore, a score of D is issued. The score can easily improve if forecast errors are decreased. In 2012, a score of C was issued, since projections were provided but there was no sensitivity analysis. Reliability of forecasts was not an explicit requirement in the previous methodology.

**Dimension 2**

The MoF has adopted a practice of conducting and disclosing DSAs as part of the Economic Reform Program (ERP) document prepared in line with the European Integration Process and the SAA since 2015. The DSA included in the report examines two main scenarios, the baseline and the investment clause, followed by further sensitivity analysis of debt subject to changes in the underlying macroeconomic indicators. The latest DSA was conducted in 2017 and includes a scenario analysis of a decrease in GDP growth by one percentage point, lowering the short-term asset balance from 4.5 percent to 3 percent of GDP, and temporarily increasing the overall deficit to 5 percent of GDP. The following variables are calculated to estimate the impact of the shocks stated above: NPV of debt/GDP, NPV of debt/revenues, NPV of debt/total exports, debt servicing/total exports, and debt servicing/revenues. The DEPPFC uses its own model to conduct the DSA.

As the MoF has been annually preparing detailed DSAs since 2015, this dimension is rated as A. In 2012, a score of C was issued as DSA were not conducted regularly.

### DPI 7: Coordination with Monetary Policy

| Dimensions | Score |
|---|---|
| 1. Clarity of separation between monetary policy operations and DeM transactions | N/A |
| 2. Coordination with the central bank through regular information sharing on current and future debt transactions and the central government's cash flows | N/A |
| 3. Extent of the limit of direct access to financial resources from the central bank | A |

**Dimension 1**

Kosovo is a fully euroized economy and the CBK has no active monetary policy. Nor does the CBK issue its own securities. Market liquidity is purely determined by inflows and outflows.

Although this dimension had been rated as A in 2012, the 2015 methodology more clearly stipulates that in the absence of monetary policy, this dimension should be rated as N/A.

**Dimension 2**

The official information sharing mechanism between the MoF and the CBK is the Liquidity Committee, which oversees the investment policy for the government's cash balances (see DPI-11). The committee used to meet regularly until 2015, and projections for the cash balances were shared. The main objective in producing the projections was to monitor the amount to be invested. This information did not imply any monetary policy response on the side of the CBK as it lacks monetary policy tools. Diminished

[14] According to the 2015 DeMPA methodology, the quality of such forecasts is considered "reasonably reliable" when the difference between forecasted and actual debt service outturn is less than 10 percent.

opportunities for generating positive returns for EUR-based investments have meant that there is currently no active investment operation in place. Consequently, the committee meetings were also suspended.

In 2012, this dimension was not rated reflecting the absence of monetary policy. The rating is changed to N/A following a methodological change.

**Dimension 3**

Article 33 of the CBK law clearly prohibits CBK direct lending except for intra-day loans (no interest) that should be settled on the same day. While the CBK holds a significant portion of the government's domestic debt (around 35 percent of outstanding as of August 2017), all these securities were purchased through secondary market operations from PD banks. The rating stays the same at A as in 2012.

## 4.3. Borrowing and Related Financing Activities

## DPI-8 Domestic Borrowing

| Dimensions | Score |
|---|---|
| 1. The extent to which market-based mechanisms are used to issue debt; the preparation of an annual plan for the aggregate amount of borrowing in the domestic market, divided between the wholesale and retail markets; and the publication of a borrowing calendar for wholesale securities | C |
| 2. The availability and quality of documented procedures for borrowing in the domestic market and interactions with market participants | A |

**Dimension 1**

The GoK has been issuing securities in the domestic market since 2012. Since then all domestic borrowing has been market-based. Regulation MoF-CBK No. 01/2014 for the Primary and Secondary Market of Government Securities of the Republic of Kosovo, jointly signed by the two institutions, includes the framework to regulate issuance of securities and the functioning of the secondary markets. The CBK acts as the fiscal agent of the GoK in accordance with the LPD. The role of the CBK in the domestic borrowing process is stipulated by the above-mentioned regulation.

The GoK issues both T-bills (182-day, and 364-day) and T-bonds (2-, 3- 5-, and 7-year). There are 8 primary dealers (PD) comprising banks, and 1 primary participant – the KPSF. The KPSF is does not trade in the secondary market. Other participants can enter auctions through the eight PD banks. The banks, which hold slightly less than half of outstanding domestic debt, are the main holders. Most of the remaining balance is held by the CBK and KPSF. The CBK acquires government securities in the secondary market, through over-the-counter transactions with PDs based on the PD contract.

The DMD prepares an annual borrowing calendar by instrument for the entire year. This is for internal planning purposes and not published. A quarterly auction calendar for 3-months ahead with amounts and dates is published on the MoF website. The calendar contains information on the types of instruments, dates and amounts to be issued for the first following month while it only provides the type

of instruments and dates of auction (no amounts) for the two other months. Further details of auctions are announced one week ahead of the auction date. In line with Regulation No: 05/2014, bidders are notified of their own status within two hours after the auction. A consolidated summary of the auction results is disclosed on the CBK website and on the MoF website on the following business day after each auction, i.e. on the settlement day. Auction Results are also released through social media and a press release.

Since the government raises funds from domestic markets entirely through market-based mechanisms, prepares an annual borrowing plan, and publishes a quarterly auction calendar, this dimension is rated as C. A higher grade would require that the auction result is publicly disclosed on the day of the issuance at the same time to all participants, which is currently not the case. Only the bidders can see the outcome of the bids on the same day (and information is limited by the outcome of their own bids). This dimension was rated as D in 2012 as this was the first year when domestic securities were issued and a domestic borrowing calendar had not yet been published.

**Dimension 2**

Regulation MoF-CBK No. 01/2014, which is publicly available on the MoF website, contains procedures for domestic borrowing and participation in auctions. All domestic borrowing is through auctions, and based on a decision issued by the Minister (Decision No. 05/2014) auctions are multiple price. Definitions of instruments and their features, general and specific conditions for T-bill and T-bond auctions, participation, bidding, announcement of results, and settlement procedures are described in detail in Regulation MoF-CBK No. 01/2014.

The regulation also describes the procedures for trading in the secondary market. The general framework for the PD system is also set in this regulation. Based on this, the CBK signs bilateral PD contracts. In Kosovo, an organized secondary securities market does not exist. Transactions in the secondary market are agreed between parties bilaterally and executed through the Depo/X system, operated by the CBK. The auctions are also held and settled via this system. There is no transparent price discovery mechanism in the secondary market, as the average prices are not published.

The DMD has adopted a practice of meeting quarterly with the PDs and the KPSF. These meetings are held bilaterally. The CBK is also represented. The meetings facilitate an exchange of opinions on market sentiment and borrowing policies. The PDs with whom the mission met expressed positive views on the structure of meetings and the content covered. There is no joint meeting where all PDs are represented at the same time.

Since the borrowing procedures for domestic borrowing as well as terms and conditions and criteria for access to auctions are publicly available, and there are quarterly meetings with market participants, this criterion is rated as A. The rating stays the same as in 2012.

## DPI-9 External Borrowing

| Dimensions | Score |
|---|---|
| 1. Documented assessment of the most beneficial or cost-effective borrowing terms and conditions (lender or source of funds, currency, interest rate, and maturity) and a borrowing plan | D |
| 2. Availability and quality of documented procedures for external borrowings | D |
| 3. Availability and degree of involvement of legal advisers before signing of the loan contract | A |

**Dimension 1**

Over the past years, Kosovo had conducted a prudent borrowing policy which has resulted in low borrowing costs. Kosovo's external borrowing is guided by the country's debt management strategy and consists of maximizing Euro-denominated loans at a fixed interest rate, with multilateral institutions being the largest creditors. As of now, all the loans contracted have been used to finance development projects and the borrowing terms has been mostly creditor driven.

The external borrowing process starts when a line ministry submits a project proposal to the National Investment Committee to be included in the Pipeline Project Document. Once a financing source has been identified (and in most cases, it is the creditor that proposes the project), the Minister of Finance sends the letter of request for financing to the creditor. The line Ministry and the creditor are responsible for the feasibility study. Once both sides agree to implement the identified project, the project proposal and a draft loan agreement are send to the MoF to prepare for negotiations. The MoF then sends a draft notification of intent to negotiate to the Ministry of Foreign Affairs (MFA); the notification must include the draft agreement and the proposed project to be financed. Upon approval of the intent by the Minster of Foreign Affairs, either MoF or MFA, proposes to the Governmental Cabinet to approve the initiation of negotiations with a specific creditor for a specific project. After such approval is obtained, the Minister of Finance proposes the negotiations team to the Minister of Foreign Affairs for his approval. Such proposal must also include the time, date, place, and the material which will be negotiated. Once the MFA has reviewed and approved the team, location and time it sends its confirmation to the MoF. The Minister of Finance then appoints officially the team which must include the DMD (Regulation 22/2013, Article 8). The team is also composed of the DIFC, the Legal Department of the MoF, the line Ministry, the Department of Budget, and the MFA.

Once negotiations are concluded, the head of the team prepares a formal briefing for both Minister of Finance and the Minister of Foreign Affairs. Such briefing must include a cover letter, minutes of negotiations, final draft of the agreement, and any other discussed materials during negotiations. If there are no objections by either MoF or MFA, through Prime-minister's office, a request to authorize the Minister of Finance to sign the agreement is sent to the President of the Republic. Once such authorization is granted and sent through official channels to the Minister of Finance and Minister of Foreign Affairs, the Minister of Finance is mandated to sign the agreement. After signature, the Legal Department of the MoF drafts the proposed Law for processing to the Parliament (through the Government) for Ratification. According to the Constitution, international agreements must be ratified by 2/3 of the voting power.

Agreements between the Government of Kosovo and international organizations are classified as international agreements. Therefore, the ratification of financial agreements requires 2/3rd of the votes in the Assembly. Once ratified, the agreement is sent to the President for his decree. It must then be published in the Official Gazette. The Law comes into force fifteen days after its publication.

The contracting of external borrowing can be a very lengthy process which has, sometimes, occasioned delays. In certain instances, some loans have taken more than a year before being signed and ratified.

As stated in the previous indicator (DPI2-1), the DMD is the lead negotiator for the World Bank, France, and Hungary, whereas the DFIC is the lead for the other creditors. The DMD is responsible for reviewing the financial conditions of all the loans. However, because all the borrowing comes from official creditors, the terms, in almost all cases, are known and non-negotiable. Therefore, there is no systematic analysis of the most cost-effective terms. However, some sensitivity analyses have been conducted when a variable interest rate is proposed. The DMD publishes, in the SDP, a table which contains the complete list of the terms and conditions of its creditors. Furthermore, the unit prepares an annual borrowing plan which includes the disbursements expected from its creditors. This analysis is undertaken to derive the annual borrowing ceiling included in Table 1 of the annual Budget Law. However, the annual borrowing plan remains an internal document.

As there is no systematic cost benefit analysis undertaken by the DMD, the minimum requirements for this dimension are not met and it is rated D. This is the same score as in the previous review for the same reason.

**Dimension 2**

LIA lays down legal steps needed to be undertaken before entering in any type of international agreements. The Regulation 22/2013 (Article 5) describes the process of contracting external loans. However, the secondary legislation was enacted prior to the publication of the LIA. The Regulation has not been updated and does not take into account the role of the MFA in the approbation process as required under the LIA. Therefore, it describes only partially the process detailed in the preceding dimension,

Furthermore, there is no internal procedures manual that provides the complete process of contracting external financing or defines the specific roles of the different units involved. For example, the involvement of legal advisors is not mentioned in the Regulation, although it is the current practice to include them in the negotiation team. The Regulation 22/2013 superseded the Administrative Instruction dated 2010 which previously regulated this process. In it, the role of the Legal Department of the MoF was defined (for example, being a member of the negotiating team and drafting the proposed Law of Ratification).

As there in no procedures manual and the Regulation does not conform to the current practice, the minimum requirements for the second dimension of this indicator are not met and it is rated D. The scoring is lower than the previous one which based its rating on the Administrative Instruction dated 2010 which has been replaced by the Regulation No22/2013.

**Dimension 3**

The Legal Department of the MoF is involved throughout the borrowing process. It reviews and comments on all the loan agreements and is always a member of the negotiating team. The unit is also responsible for drafting the proposed Law of Ratification, and, if required, the legal opinion after the loan has been ratified by Assembly.

As legal advisers are consulted throughout the borrowing process, the third dimension is rated A. This is the same score as the previous DeMPA.

## DPI-10 Guarantees, On-lending and Debt-related Transactions

| Dimensions | Score |
|---|---|
| 1. Availability and quality of documented policies and procedures for approval and issuance of the loan guarantees | D |
| 2. Availability and quality of documented policies and procedures for on-lending of borrowed funds | D |
| 3. Availability of a DeM system with functionalities for handling derivatives and availability and quality of documented procedures for the use of derivatives | N/A |

**Dimension 1**

Kosovo has issued loan guarantees only since 2014. As of August 2017, the total amount issued was EUR 44 million (two lines of credit for the Deposit Insurance Fund of Kosovo (DIFK) from the European Bank for Reconstruction and Development (EBRD) for the total amount of EUR 24 million which have not yet been disbursed, and one loan from EBRD for urban traffic for EUR 20 million).

The LPD (Chapter VII) and Regulation 22/13 regulate the issuance of state guarantees. The Law on Public Debt provides the framework for issuing guarantees. Chapter VII, Article 19 stipulates the entities eligible (public sector entities and private entities that finance infrastructure or projects related to an economic sector of strategic and social importance). The article also allows partial guarantees to be issued. The law assigns to the MoF the responsibility to review the proposal and submit its opinion to the Government for approval (Article 21). However, as stated in DPI-1, only the Minister of Finance is authorized to sign the guarantee (Article 19). Lastly, the Law requires that a guarantee fee be charged to the beneficiary. The fee shall be calculated based on an analysis of each guarantee's share of the expected losses of the overall guarantee portfolio.

Article 8 of the Regulation 22/2013 describes the process for issuing guarantees. The beneficiary must submit to the MoF a proposal which includes an economic and financial analysis of the proposed project. The Minister of Finance then nominates a "Team for Review of Application for Guarantees" which must include the Department of Budget, the DEPPFC and the Treasury (DMD). The team has 30 days to review and provide its recommendation. As per the Law of Public Debt, the Regulation stipulates that MoF must send it to the Government for decision. The Government has 60 days to approve the issuance of the guarantee. The Regulation indicates that, upon approval from the Government, the Minister of Finance

may sign the guarantee and prepare a draft law of ratification. Guarantees must be ratified by the National Assembly by 2/3 of the votes.

As with external debt, and for the same reasons, the Regulation describes only partially the process of issuing guarantees, namely the MFA is not included in the process. As for external loans, the MFA must provide a positive recommendation to the President of Kosovo for authorizing the negotiation and for signing it. As with the previous indicator, the Regulation is silent on the role of the legal advisor whereas the 2010 Administrative Instruction indicated that the Legal Department of MoF was responsible for drafting the draft guarantee agreement.

Furthermore, the Regulation does not assign specific responsibilities based on the functions of the members of the negotiation team. For example, the legislation does not give the responsibility of the computation of the guarantee fee to a specific entity. Currently, the DMD is responsible for it. Additionally, no methodology on how to determine the guarantee fee is included in the legislation or in a procedures manual. Thus the guarantee fee has been calculated differently for some of the guarantees. A documented methodology would increase transparency of the process.

Since there is no procedures manual nor a regulation that describes fully the current process of issuing guarantees, the minimum requirements for the first dimension are not met and is scored D. In the previous DeMPA, the dimension was rated higher. The main reason for the difference is that the Law on International Agreement has not been enacted at the time of the review.

**Dimension 2**

At the end of August 2017, on-lending operations amounted to about EUR 56 million. As with the other lending operations, on-lending is regulated by the LPD and Regulation 22/2013. Article 13 of the Law defines the eligibility criteria for such operations, and designates the Minister of Finance as the sole authority to negotiate and sign on-lending agreements. The legislation also authorizes the Ministry of Finance to change the repayment currency of the subsidiary loan, if desired, and to impose a servicing charge.

The Regulation in Article 7 defines the obligations of the beneficiary and the lending conditions – which should be based on:

- Provisions of the original agreement
- Financial conditions of the public organization and repayment plan
- Cost of the current national debt portfolio
- Relevance of the public project to be financed

However, the Regulation does not provide any methodology on how to apply these directives, nor is there a procedure manual that describes it or assigns responsibility to an entity. Furthermore, the Regulation does not describe the process for approving on-lending operations. However, under current practice, the process is the same as external borrowing, with a team nominated by the Minister of Finance responsible for negotiating the on-lending agreement (the same team that negotiates the external loan), which then submits its recommendations to the Minister of Finance for signature. The last step is for the Assembly to

ratify it. Nevertheless, the Regulation is an improvement from the Administrative Instruction which did not mention at all on-lending operations.

Currently, all on-lending agreements have had the same terms and currency as the original loans, and no service charges have been applied. However, there is no policy document that determine when such fees should be imposed.

As there is no procedures manual for on-lending operations, the minimum requirements for the second dimension have not been met and is rated D. This is the same rating as the 2012 DeMPA for the same reason.

**Dimension 3**

Kosovo has not engaged in any financial derivatives operation so far, nor is there any legal framework or specific provision to do so. As such, this dimension is rated "N/A".

## 4.4. Cash Flow Forecasting and Cash Balance Management

### DPI 11 – Cash Flow Forecasting and Cash Balance Management

| Dimensions | Score |
|---|---|
| 1. Effectiveness of forecasting the aggregate level of cash balances in government bank accounts | C |
| 2. Decision of a proper cash balance (liquidity buffer) and effectiveness of managing this cash balance in government bank accounts (including the integration with any domestic debt borrowing program, if required) | C |

**Dimension 1**

Cash management is the responsibility of the Cash Management Division (CMD) of the CDMD within the Treasury. It has 4 staff (one on maternity leave), but a large part of their work is related to budget execution, i.e. the management of budget allocations[15]. The CMD works closely with Front Office of the DMD in the preparation of cash flow and cash balance forecasts. The Budget Organizations (BOs) and revenue authorities (Tax Administration, and Customs and Excise) prepare monthly profiles of their approved annual budgets at the start of the year. These profiles are an input into the preparation of monthly cash flow forecasts, although in practice for expenditure forecasts the CDMD relies more heavily on the profile of historical data over the last 3 years.

The CDMD updates each month the monthly forecasts for the rest of the year. The BOs and revenue authorities formally update their profiles only at the time of the mid-year budget review, unless there

[15] Authority to commit and spend the approved budget is released monthly for wages and salaries and quarterly for other expenses, on the basis of profiles submitted by BOs. However, authority is given to a detail required by a 5-digit code, and BUs have to seek central approval for any changes greater than 5 percent. The CMD has to monitor and record a large number of such changes. (It is planned to relax this arrangement somewhat in 2018 with control reverting to the main economic categories).

have been other significant changes. But the CDMD has access to daily outturn data, and as necessary will discuss with the BOs and tax authorities any implications for future monthly cash flows. Particular attention is given to major infrastructure projects. On occasions in the past, at times of pressure on cash balances, the CDMD has focused on more detailed forecasts over the weeks and days immediately ahead, but that is unusual and has not been necessary over the last 2-3 years.

Kosovo has a modern Treasury Single Account (TSA) and all government cash is held at the Central Bank of Kosovo (CBK). BOs have sub-accounts within the TSA, but they are only notional or ledger accounts ("permissions to spend") with the cash held in the top account. Tax receipts are swept back into the TSA from the commercial banks on the same or next day, depending on the time of day. The cash flow forecasts are therefore geared closely to cash balances that are under the MoF's control; and they are an input into the monthly decision on the auction calendar for the following 3 months[16]. Issuance decisions take into account the need to maintain the required cash balances, although there is a limited attempt to smooth cash flows. Indeed, the MoF has not recently issued any 3-month T-bills, in order to lengthen the average maturity of the portfolio somewhat; however, the CDMD recognizes that 3-month T-bills will need to be reintroduced when there is more pressure on government liquidity.

Until recently, a Liquidity Committee, jointly chaired by the Treasury Director and Deputy Governor of the CBK, has met monthly to consider the investment of the government's cash balances. The Treasury and the CBK have prepared a formal Investment Policy as required under the LPFMA (Section 8) and a Memorandum of Understanding between the two institutions governing the terms and conditions of investment. The allowed investments are highly constrained, to limit both credit and liquidity risks.

In practice the Liquidity Committee has not met recently. There are no decisions to be made. The MoF has left its balances with the CBK. It can invest them and pass the return onto the MoF but the return on available investments is zero (or negative, although the CBK has not passed on negative rates). The combination of IMF's required cash buffer (see dimension 2) and the lack of suitable investment choices has rendered otiose the MoF's own target to manage balances in the TSA to at least EUR 50 million. The Liquidity Committee will meet again when positive returns become available.

Reasonably reliable monthly aggregate forecasts of cash inflows and outflows and cash balances are available for the budget year and updated monthly. That warrants a score of C. A higher score would require weekly cash flows for the coming month. In 2012, a score of A was issued on the basis of more granular forecasts for the upcoming month, a practice that was suspended as a result of diminished investment options.

**Dimension 2**

Under the Stand-By Arrangement with the IMF, Kosovo has a performance criterion to maintain bank balances equivalent to at least 4.5 percent of GDP. Bank balances are defined broadly to include all funds useable and readily available (i.e. liquid or marketable) controlled by the government. The Government fell short of this requirement at end-2014, and by a much smaller amount at the end of 2015 (although

[16] The forecasts for 2016 were very accurate over the year as a whole, with an average monthly error on net flows (including financing items) of less than EUR 3 million (an error of about 2 percent on each of inflows and outflows). However, there were more significant errors from month to month, with December being especially problematical in view of the end-year surge. Over the first 8 months of 2017, forecasts of revenue have been very close to outturns (an average error of just 0.3 percent), but outflows have been underestimated by 17 percent).

this was a reflection of delays in disbursements from the IMF). Since then the balance has been above 4.5 percent (at end August 2017 it was close to 5 percent, or EUR 320 million).

The MoF does take its cash flow forecasts into account in planning issuance, with a view to meeting its cash balance target. Surplus cash is managed though investment in the market or the CBK although current interest rates imply only passive decision making. This merits a score of C; much more active use of T-bills to smooth cash flows would be required for a higher score. The rating stays the same as in 2012.

## DPI 12 - Debt Administration and Data Security

| Dimensions | Score |
|---|---|
| Availability and quality of documented procedures for the processing of debt-related payments | C |
| Availability and quality of documented procedures for debt and transaction data recording and validation, as well as storage of agreements and debt administration records | C |
| Availability and quality of documented procedures for controlling access to the central government's debt data recording and management system and audit trail | C |
| Frequency and off-site, secure storage of debt recording and management system back-ups | A |

**Dimension 1**

Processing of debt service is organized by the Regulation 22/2013 which states that the DMD, within Treasury, shall be responsible for filling and maintaining all documents related to state debt (Articles 6.12 and 12). The Treasury is responsible for registering and reporting on state debt.

Procedures for debt and transaction data recording and validation are further detailed in two procedures manuals:

- Debt and transaction data recording and validation, updated in April 2017
- Record payments and receipt disbursements for budget organizations, updated in April 2017

The back office updates the procedure manuals in coordination with the Deputy Treasurer on a needs basis and the final document is approved by the Treasurer. The procedures are reviewed every time there is a change in the process. Printed versions of these procedures are located in the DMD office, and also scanned copies of procedures are sent via e-mail by the Treasurer's office to Treasury staff.

The procedures specify that any loan negotiated by the MoF, and ratified by the Assembly, shall be registered as a separate instrument in CS-DRMS. Registration of financial instruments in CS-DRMS is under the responsibility of the back office in the DMD. All new loans created in the system require approval by the Deputy Treasurer for Cash and Debt Management (Head of CDMD) to become effective in the system, as detailed in the procedures.

Invoices from creditors are received by the back office and reconciled with the CS-DRMS, and related payment orders are prepared by the back office manually. They are signed by the Treasurer and Deputy

Treasurer (four eyes validation) and sent two days before the due date to the CBK for execution. The back office, the day after submitting the payment order to the CBK, checks if the sub-account of the TSA has been debited accordingly, as the CBK does not notify the MoF automatically. Once the payment has been verified, the operation is recorded in the CS-DRMS. Although electronic processing of the payment orders was envisaged, it was decided to maintain manual processing because of limited staffing and the necessary training required to use the tools to process payment orders for high level managers.

Finally, the back office prepares the voucher to be sent to the accounting department to have the transaction recorded in the KIFMIS. There is no interface between the KIFMIS and the CS-DRMS, hence double data entry in CS-DRMS and in KIFMIS is required.

This dimension is rated C, as there are readily available procedures manuals for the processing of debt payments which are updated on a regular basis (last update April 2017). However, as the payment orders are not prepared electronically, a higher score could not be granted. The rating stays the same as in 2012.

**Dimension 2**

The LPD prescribes, in its Article 28, the recording of state debt and guarantees. The procedure in regards to data entry of new loans is detailed in the "Procedure on Authority and Use of Debt Management System (CS-DRMS)" which covers the use, recording and reporting using the CS-DRMS. The CS-DRMS procedures were updated in August 2014.

The back office is responsible for recording new financial agreements, all transactions, debt servicing (verification of bills and preparing the transfers) and disbursement approvals. Ratified financial agreements, including those negotiated with IFIs, are published on the Official Gazette website. They are signed in three original copies, of which one is kept by the creditor, one is archived at the MFA and one in the MoF. The MoF original agreement is archived in a locked metal cabinet in the DMD office on the 10$^{th}$ floor of the MoF. In addition, the DMD maintains several hard and soft copies in different offices and on servers that are securely backed-up. Scanned copies of the financial agreements are also attached to the loan instrument in the CS-DRMS. The CS-DRMS procedures manual requires that original agreements and all credit-related documents are physically placed in a file that should be kept in a secure place where only the Debt Unit may have access.

In order to avoid mistakes and misinterpretations of financial agreements, the CS-DRMS procedures manual requires that, prior to the registration of a new financial instrument in the database, the back office, in cooperation with the middle office, prepares a Data Entry Sheet (DES). The DES is submitted to the front office for review and signature. Once approved by the front office, the back office can record the instrument in the CS-DRMS based on the specifications detailed in the DES. Disbursements and payments, before being recorded in the CS-DRMS, are verified against disbursement notifications and invoices sent by the creditor and validated with the debt database.

Effective procedures for debt and transaction data recording and validation are readily available and updated, and include procedures for the storage of original agreements. This dimension is rated C. To achieve a higher score, the procedures should be updated every second year. The rating in 2012 was D since procedures had not yet been drafted.

**Dimension 3**

The CS-DRMS procedures manual defines the access rights of users within the Treasury (Part 3.1). This manual was updated in August 2014.

Access rights are determined based on the functions detailed in the job description of the user and authorized access is permitted with special request from the Deputy Treasurer. The Information Technology (IT) department is responsible for creating users' access rights based on the Treasurer's authorization. Access permissions are updated every time users' responsibilities change. The IT staff in charge of the MoF is new and confirmed he received procedures from previous colleagues to perform this duty.

Access to the CS-DRMS requires a three-level password access (access to staff work station, log in to MoF network and to the CS-DRMS application). The system has the possibility to produce audit trails, but this is not a requirement or regulated in the procedures. Audit trails are not used by the DMD.

This dimension is scored C. A higher score could not be granted as the update of the CS-DRMS procedures is three years old and best practice recommends that this be undertaken every second year. The same rating was issued in 2012.

**Dimension 4**

The back-ups of the CS-DRMS database are made on a daily and weekly basis. They are stored in the IT server room of the MoF, which is protected against fire (sprinklers) and floods (pipes), and off-site in the Ministry of Public Administration building. Access to the MoF server room is only possible with the MoF electronic badge with special access to this area and with a digital code.

The CBK does live back-ups every day. DEPOX is replicated between two datacenters (over 60 km distance) in real time, and backups are performed on daily bases using a dedicated backup software. Backups are also stored off-site, at the Treasury.

Based on recommendations from the internal auditor, a testing environment for the CS-DRMS has been put in place to allow for disaster recovery tests and validation of the back-up files before being uploaded in the production environment.

The MoF IT policies and CS-DRMS procedures manual provide for instructions on the back-up policy and disaster recovery and business continuity.

The score remains A, based on the high quality of storage and back-up policy and practices. The ratings stay the same as in 2012.

## DPI 13 - Segregation of Duties, Staff Capacity, and Business Continuity

| Dimensions | Score |
|---|---|
| 3. Segregation of duties for some key functions, as well as the presence of a risk monitoring and compliance function. | D |
| 4. Staff capacity and human resource management | D |
| 5. Presence of an operational risk management plan, including business continuity and disaster recovery arrangements | D |

**Dimension 1**

The organization of the DMD is given in the regulation 06/2014 on internal organization and systematization of jobs positions within Kosovo Treasury (Article 9). The regulation describes its duties and responsibilities and the staffing. The DMD is organized de facto in a front-back-middle-office structure. However, the regulation does not formally provide for the separation between the different functions. In addition, the DMD has only three staff members who act as front, back, middle office respectively. In such circumstances, it is very difficult to guarantee an effective segregation of duties as in absence of one staff, the others have to compensate, compromising strict segregation.

In the absence of a formal organizational structure and as a result of the low number of staff, there is no clear segregation of duties. Hence this dimension is scored D. The rating stays the same as in 2012 for the same rationale.

**Dimension 2**

Detailed job descriptions are available for the DMD staff who are recruited according to a competitive process based on experience, and on the knowledge of candidates evaluated through written tests and interviews. Performance assessment of staff is conducted at the end of each year by the supervisor. Staff of the DMD receive regular specific training, including by international organizations such as the Work Bank.

The staff members of the DMD have adequate training to undertake their responsibilities and demonstrate proficiency in their work. However, the number of staff is not sufficient to ensure effective segregation of duties, which represents a major operational risk.

The DMD has also faced high staff turnover over the past years. DMD staff used to benefit from the "brain funds", a compensation scheme which was doubling their salary. Its removal has affected staff motivation negatively, leading to departures from the unit.

Problems in the determination of the grade of the posts has also affected motivation. Originally, the 3 positions of the DMD were named as heads of front, back and middle office. When the head of the middle office left the DMD, it was not possible to recruit a new head of middle office and, based on the requirements of the MoF jobs catalogue, a debt management officer was recruited (at the same level). This process left the position vacant for 10 months. In addition, the position of Head of the DMD is vacant and will not be recruited in the short-term. A new premium is being submitted for Government's approval to complement the salary of the DMD staff with a view to limiting the risk of turnover.

Despite competent and dedicated personnel in the DMD, this dimension is scored D since the reduced staffing represents a major operational risk. The rating in 2012 was the same.

**Dimension 3**

Administrative instruction No. 02/2014 standardizes the IT framework on operations support and continuity of service/back-up and disaster recovery across all MoF IT systems, including Treasury systems such as KIFMIS and CS-DRMS. The CS-DRMS is under the responsibility of Treasury IT department. The CS-DRMS procedures manual covers disaster recovery, referring to IT policies applicable in such a situation.

The disaster recovery and business continuity plan of the MoF concentrates on the IT dimension and on the restoration of data. However, it does not cover arrangements for continuing debt management

activities, and because of the limited number of personnel in the DMD, minimum staffing to resume business operations cannot be guaranteed as soon as one person is missing.

The CBK has a comprehensive disaster recovery and business continuity plan. In addition, it has set up a business continuity center in Prizren (around 80 kms from Pristina) with the technical and logistical infrastructure to resume business. The CBK conducts on a quarterly basis disaster recovery tests of Depo/X with no prior announcement. To date, all the tests have been successful, including during a live auction.

Finally, the disaster recovery and business continuity plan in place at the CBK is included in the audit plan of the CBK and processes are monitored on a regular basis by the internal auditors. This year, the internal auditors concentrated on access rights and the segregation of duties in place for the system. No issue was identified by the auditor in this regard. Discussions are ongoing with the MoF to use part of the CBK facilities for the MoF needs.

A comprehensive disaster recovery and business continuity plan is currently in discussion between the MoF and CBK to allow the MoF to use CBK facilities in Prizren.

This dimension is scored D, reflecting the absence of specific instructions in resuming debt management activities in the disaster recovery and business continuity plan of the MoF, and the major operational risk linked to the limited staffing of the DMD. The same rating was issued in 2012.

## DPI 14 - Debt Records

| Dimensions | Score |
|---|---|
| 1. Completeness and timeliness of central government records on its debt, loan guarantees, and debt-related transactions | A |
| 2. Complete and up-to-date records of all holders of government securities in a secure registry system, if applicable | A |

**Dimension 1**

It is of the responsibility of the DMD to record external and domestic debt in the CS-DRMS. CS-DRMS was purchased and installed in 2009. The version currently in use is CS-DRMS version1.3, which is an old version of the system. The database relies on Microsoft SQL Server. All external and domestic debt is recorded in the CS-DRMS, including inherited debt which was consolidated under the Paris Club.

New external debt instruments are registered in the database within a one-month lag. Although it is still within international standards, some deterioration has occurred since 2012 (at which time debt records were updated within one week). The increasing workload and limited number of staff in the back office impacts the timeliness of recording. Disbursements are recorded upon notification by the creditor and verification of transfer. Payments are recorded immediately after execution.

Domestic debt data are imported into the CS-DRMS using a XML file sent by the CBK after each operation. An automatic link was envisaged to be developed between the Depo/X and the CS-DRMS, but could not be completed as the systems were not compatible (the version of the CS-DRMS is too old to be compatible with the CBK registry).

Guarantees are currently recorded on a separate Excel database as the version of the CS-DRMS in use at the DMD has no module allowing for the recording of guarantees. The Excel spreadsheet is updated within a one-month lag and is saved in the shared drive of the Treasury, which is covered by automatic back-ups and the disaster recovery plan of the MoF. The MoF is planning for the update of the system and informed the mission that as soon as the system allows, the guarantees will be recorded in the debt database.

Debt records are complete and up-to-date within a one-month lag for central government domestic, external and guaranteed debt, as well as all debt-related transactions. Hence, this dimension scores A as in 2012.

**Dimension 2**

By law, the CBK is responsible for the registration of issues and transfer of dematerialized securities and for maintaining a registry for securities issued by the State[17]. The registry system, Depo/X,[18] is located at the CBK and is a component of the central securities depository system (CSD). It includes an automated registry for the issuance of government securities, an electronic platform for the primary auction and settlement of government securities based on "Delivery vs Payment", and an electronic platform for the secondary market settlement and clearance of government securities. Depo/X acts as depository for all securities issued by the Government of Kosovo.

The Depo/X has complete records of the all holders of government securities, including on the secondary market. The Investment and Security division of the CBK has a procedures manual describing the roles and the screens in relation to the CSD. Any operation in Depo/X requires a four eyes validation. The market regulations require the PDs to record in the Depo/X their transactions in the primary and secondary markets, including the details on the final holders of the bonds. Access rights to the CSD are closely monitored by the IT department of the CBK. CBK staff access rights are directly specified in the job descriptions and changes are immediately integrated in the system. Access differs based on the functions (front-back-middle office). For PDs, a prior notice of 2 weeks is required to modify the access rights. Access for PDs requires a 2-level authentication (an electronic certificate and login/password). Domestic debt records in the Depo/X are not automatically exported to the CS-DRMS because of incompatible technology. Hence, scripts are given to the MoF with auction details and results, which are then imported manually in the CS-DRMS after each auction.

Back-up procedures are set by the IT department. Online live back-ups are automatically made. In addition, daily back-ups are stored in an offsite location. Finally, every 3 months, the CBK conducts disaster recovery and business continuity tests. As noted above, these are conducted with no prior announcement; they have already occurred during a real auction and the CBK managed to work on remote servers with no interruption of activity. Business continuity facilities are set up for the CBK in Prizren.

The registry is regularly audited by external auditors and the internal IT auditor audits the system, concentrating on access rights and segregation of duties in the system. In addition, the CBK also reports to external auditors of commercial banks for the outstanding amount of respective banks at the end of each year. Hence this dimension scores A. The rating has improved from C in 2012 as there had not yet been audits of the systems.

[17] See Article 16 of the LPD and Article 30.4 of the CBK Law

[18] Depo/X has been developed and supported by CMA Small Systems in Sweden (http://www.cma.se/products/depox-full-function-central-depository-system.html)

## Annex 1: DeMPA Mission Agenda

**September 26–October 3, 2017**

| | | |
|---|---|---|
| **Tuesday, September 26, 2017** | | |
| **11.00-12.00** | Meeting at MoF<br>Mission Launch Meeting | General Director of Treasury<br>Mr. Ahmet Ismaili |
| **13.00-14.00** | Meeting at MoF<br>Technical Introduction Meeting | MoF Staff<br>CDMD |
| | Meeting at MoF<br>Legal and organizational framework for debt and cash management | MoF Staff<br>CDMD |
| **14.00 – 15.30** | Meeting at MoF<br>Treasury and Cash Management | MoF Staff<br>CDMD |
| **15.00- 16.00** | Meeting at MoF<br>Domestic Debt Management | MoF Staff<br>CDMD |
| **Wednesday, September 27, 2017** | | |
| **9.00 – 11.00** | Meeting at MoF<br>Budget Formulation and execution, links with cash management, revenue and expenditure projections, macro projections, debt sustainability analysis | MoF Staff<br>Mr. Azem Recica,<br>Mrs. Blerta Kika<br>Mrs. Ganimete Xhaka |
| **13.00-16.00** | Meeting at Central Bank<br>Monetary Policy Issues/Operations, liquidity forecasts, links with government cash Management, auction execution, payment and registry<br>Internal Audit | CBK Staff-<br>Mr. Arben Mustafa,<br>Mr. Florim Maxharraj,<br>Mr. Faton Ahmetaj,<br>Mr. Shkendije Nahi ,<br>Mr. Ermal Leci |
| **Thursday, September 28, 2017- TEAM I** | | |
| **9.00-10.30** | Meeting at Tax Administration<br>Revenue projections and collection | Mr. Nahit Sharku |
| **11.00-12.00** | Meeting at Customs Administration<br>Revenue projections and collection | Mr. Bajram Rexha,<br>Mr. Ibrahim Xhaka,<br>Mr. Burim Gashi,<br>Mr. Jashar Goga |
| **13.30-14.30** | Meeting at the Ministry of Infrastructure | Mr. Besnik Hajdari |
| **15.00-16.00** | Meeting at the Ministry of Agriculture, Forestry and Rural Development | Mrs. Bahrije Simnica |
| **Thursday, September 28, 2017- TEAM II** | | |
| **9.00 – 10.00** | Meeting at MoF<br>External Debt Management | MoF Staff |
| **10.30-12.00** | Meeting at MoF<br>IT Systems, Debt Recording | MoF Staff |
| **13.00-14.00** | Meeting at MoF<br>Issuance of loan guarantees | MoF Staff |

| | | |
|---|---|---|
| **15.00-16.00** | Meeting at MoF<br>On-lending | MoF Staff |
| **Friday, September 29, 2017** | | |
| **10.00 – 11.30** | Meeting at National Audit Office | Mr. Qerkin Morina |
| **13.00- 14:00** | Meeting with market Participants<br>Kosovo Pension Savings Fund | Mr. Minator Maxhuni<br>Mr. Vershim Hatipi |
| **14:00-15:00** | Meeting at MoF<br>HR Department | Mr. Xhevat Zejnullahu |
| **15.00 – 16:00** | Meeting at MoF (or other relevant agency)<br>Legal Advice on Foreign Loans (if applicable) | Mr. Enis Spahiu<br>Mrs. Bahrije Berisha |
| **Monday , October 2, 2017** | | |
| **10:00-11:00** | Meeting with Market Participants<br>RBKO | Mr. Berat ISA |
| **11.00-12.00** | Meeting with Market Participants<br>NLB | Ms. Boryana Ivanova Mustafa |
| **13.00-14.00** | Meeting with the Minister of Finance | Mr. Bedri Hamza |
| **14.00-15.00** | Meeting at MoF<br>Internal Auditor of the Treasury | Mr. Jeton Qorri |
| **Tuesday, October 3, 2017** | | |
| **9.00 -10.00** | Meeting with Market Participants<br>BPB | Mr. Gazmend Rrustemi<br>Mr. Seladin Ujkani |
| **10.00-12.00** | Meeting at MoF<br>Closing meeting | MoF Staff |
| **16:00-17:00** | Meeting at WB office | WB Staff |

## Annex 2: DeMPA Comparison (2012 and 2017)

| DPI | Title | Score 2012 | Score 2017 | Comments |
|---|---|---|---|---|
| **DPI – 1** | **Legal Framework** | | | |
| 1 | The existence, coverage, and content of the legal framework | **C** | **D** | The rating is lower than the previous assessment. The legislation provides clear authority to Minister of Finance to sign loan agreements and guarantees, as well as purposes of borrowing and annual report to the Assembly. However, the last report does not provide information on debt management activities nor an evaluation of previous performance. As such, the Public Debt Law is not fully implemented. Hence the rating under the DeMPA methodology. |
| **DPI - 2** | **Managerial Structure** | | | |
| 1 | The managerial structure for central government borrowings and debt-related transactions | **C** | **D** | The rating is lower than in the previous assessment. Two entities are involved in Debt Management: Debt Management Unit of Treasury (front office for some external debt and domestic debt, middle and back office and International Financial Corporation (main front office for external debt). However, activities are not coordinated through a formal coordination mechanism. Repartition of functions was done through an e-mail from Minister of Finance. |
| 2 | The managerial structure for preparation and issuance of central government loan guarantees | **N/R** | **C** | As guarantees have been issued since the last review, the dimension is now rated. Loan guarantees are analyzed and negotiated by a team, coordinated by the DMD, and signed by the Minister of Finance. However, since there is not a formal framework that describes the process in full, this dimension is rated as C. |
| **DPI - 3** | **Debt Management Strategy** | | | |
| 1 | The quality of the debt management strategy document | **D** | **A** | The government has adopted a practice of publishing and updating debt management strategies since 2013. The recent strategy contains targets for risk indicators, based on a detailed analysis. There did not exist a document compliant with the requirements of this dimension in 2012. |

| DPI | Title | Score 2012 | Score 2017 | Comments |
|---|---|---|---|---|
| 2 | The decision-making process, updating, and publication of the debt management strategy | **N/R** | **A** | The strategy is prepared by the DMD in line with the budget and MTFF targets, CBK's views are obtained. It is formally approved and published. Annual plan is in line with the strategy. This dimension was not rated in 2012. |
| **DPI - 4** | **Reporting, publication, and evaluation of debt management operations** | | | |
| 1 | Quality and timeliness of the publication of a debt statistical bulletin (or its equivalent) covering central government debt, loan guarantees, and debt-related operations. | **D** | **A** | A quarterly debt statistical bulletin with main risk indicators is published within two months after each quarter. The bulletin did not exist in 2012. |
| 2 | The presentation and content of an annual evaluation report to the parliament or congress on DeM activities and general performance. | **C** | **D** | There is an annual bulletin with statistical data and the SDP with the strategy with some discussion on realization with respect to the targets. However, these do not contain the details of DeM operations (or a detailed assessment of DeM activities). The 2012 report contained details of operations. |
| **DPI - 5** | **Audit** | | | |
| 1 | Frequency of financial audits, compliance audits, and performance audits of the central government as well as publication of the external audit reports | **D** | **C** | The score improved as compared to 2012. A financial and compliance audit of DM transactions is conducted annually by NAO, but no external performance audit has been conducted in the past 2 years. |
| 2 | Degree of commitment to address the outcomes from internal and external audits | **N/R** | **N/R** | This dimension was not rated in 2012 since no audit of government debt management operations had been conducted. In 2017, the dimension is again not rated (N/R) since the response to NAO's comments was under preparation, and could not be evaluated by the mission. |
| **DPI – 6** | **Coordination with Fiscal Policy** | | | |
| 1 | Support of fiscal policy makers through the provision of accurate and timely forecasts on total central government debt service under different scenarios | **C** | **D** | A score of D is issued since there deviations between actual and projected interest payments. In 2012, a score of C was issued, since projections were provided but there was no sensitivity analysis. Reliability of forecasts was not an explicit requirement in the previous methodology. |

| DPI | Title | Score 2012 | Score 2017 | Comments |
|---|---|---|---|---|
| 2 | Availability of key macro variables, an analysis of debt sustainability, and the frequency with which it is undertaken | **C** | **A** | The rating has improved since the MoF has adopted a regular practice of conducting DSAs, published in the ERP. |
| **DPI - 7** | **Coordination with Monetary Policy** | | | |
| 1 | Clarity of separation between monetary policy operations and debt management transactions | **A** | **N/A** | Euro has been adopted as the national currency and CBK has no active monetary policy. Nor does it issue its own securities. Although this dimension had been rated as A in 2012, the 2015 methodology stipulates that in the absence of monetary policy, this dimension should be rated as N/A |
| 2 | Coordination with the central bank through regular information sharing on current and future debt transactions and the central government's cash flows | **N/R** | **N/A** | In 2012, this dimension was not rated due to absence of monetary policy. The rating is changed to N/A due to methodological change. |
| 3 | Extent of the limit of direct access to financial resources from the central bank | **A** | **A** | Article 33 of CBK law prohibits CBK direct lending to government except for intra-day loans that should be settled on the same day. Rating stays the same. |
| **DPI - 8** | **Domestic Borrowing** | | | |
| 1 | The extent to which market-based mechanisms are used to issue debt; the preparation of an annual plan for the aggregate amount of borrowing in the domestic market, divided between the wholesale and retail markets; and the publication of a borrowing calendar for wholesale securities | **D** | **C** | This dimension was rated as D in 2012 as this was the first year when domestic securities were issued and a domestic borrowing calendar had not yet been published. As of 2017, all domestic borrowing is market-based, the MoF prepares a borrowing program and publishes quarterly auction calendars on a rolling horizon basis. However, the auction result is not publicly available on the day of the auction. |
| 2 | The availability and quality of documented procedures for local-currency borrowing in the domestic market and interactions with market participants | **A** | **A** | Details regarding terms and conditions of securities, participation in auctions and settlement are set by a joint regulation by the MoF and CBK (No:1/2014) and is publicly disclosed. The MoF arranges one-to-one meetings with primary dealers on a quarterly basis. Rating stays the same. |

| | | | | |
|---|---|---|---|---|
| **DPI - 9** | **External Borrowing** | | | |
| 1 | Documented assessment of the most beneficial or cost-effective borrowing terms and conditions (lender or source of funds, currency, interest rate, and maturity) and a borrowing plan | **D** | **D** | The rating is the same as the previous review for the same reason. No analysis of the most beneficial or cost effective is undertaken by DMU as terms are known and non-negotiable. The DMU prepares an internal annual borrowing plan to justify the borrowing ceiling included in the Budget Law, as well as borrowing terms in the DMS. |
| 2 | Availability and quality of documented procedures for external borrowings | **A** | **D** | Rating is lower for the following reason. Resolution 2013 has replaced Administrative Instruction which was used in the last DeMPA to make its assessment and replace by Resolution No22/2013. The Resolution describes the process and steps to acquire external borrowing. However, the resolution does not describe the role of the Ministry of Foreign Affairs in the process (defined by the Law on International Agreements), and assign the role to Treasury to explore the market for funding whereas the function has been transferred to IFC There is no internal procedures manual either. |
| 3 | Availability and degree of involvement of legal advisers before signing of the loan contract. | **A** | **A** | The rating remains the same as the last review for the same reason. The legal department of the Ministry of Finance is involved throughout the process. |
| **DPI – 10** | **Loan Guarantees, On-lending and Debt-related Transactions** | | | |
| 1 | Availability and quality of documented policies and procedures for approval and issuance of central government loan guarantees | **C** | **D** | The scoring for this dimension is lower than the previous review for the same reason as DPI9-2. The resolution does not include the role of the Ministry of Foreign Affairs in the process. |
| 2 | Availability and quality of documented policies and procedures for on-lending of borrowed funds | **D** | **D** | Same rating as the last review. There is no procedure manual for on-lending operations, and the Resolution No22/2013 does not describe the current practice. |
| 3 | Availability of a DeM system with functionalities for handling derivatives and availability and quality of documented procedures for the use of derivatives | **N/R** | **N/A** | No derivatives are undertaken. Different rating because of the change of methodology. |

| | | | | |
|---|---|---|---|---|
| **DPI – 11 Cash Flow Forecasting and Cash Balance Management** | | | | |
| 1 | Effectiveness of forecasting the aggregate level of cash balances in government bank accounts | **A** | **C** | The rating has changed as the CDMD has stopped producing granular forecasts as result both of the diminished options for securing a return on the cash balance, and of staffing constraints. |
| 2 | Decision of a proper cash balance (liquidity buffer) and effectiveness of managing this cash balance in government bank accounts (including the integration with any domestic debt borrowing program, if required) | **C** | **C** | The MoF does take its cash flow forecasts into account in planning issuance, with a view to meeting its cash balance target. Surplus cash is managed though investment in the market or the central bank, although current interest rates imply only passive decision making. Much more active use of T-bills to smooth cash flows would be required for a higher score. The rating stays the same. |
| **DPI – 12 Debt Administration and Data Security** | | | | |
| 1 | Availability and quality of documented procedures for the processing of debt-related payments | **C** | **C** | The rating for this indicator remains the same as in 2012. Procedures manuals are regularly updated. However, payment orders are prepared manually. |
| 2 | Availability and quality of documented procedures for debt and transaction data recording and validation, as well as storage of agreements and debt administration records | **D** | **C** | Effective procedures for debt and transaction data recording and validation are readily available and updated and include procedures for the storage of original agreements. Rating has improved since procedures have been developed since 2012. |
| 3 | Availability and quality of documented procedures for controlling access to the central government's debt data recording and management system and audit trail | **C** | **C** | The procedures to control access for the CS-DRMS were updated 3 years ago. Despite this update, it should be undertaken every second year, hence this justifies the same level of scoring. |
| 4 | Frequency and off-site, secure storage of debt recording and management system back-ups | **A** | **A** | The score remains A, based on the high quality of storage and back-up policy and practices. |
| **DPI – 13 Segregation of Duties, Staff Capacity and Business Continuity** | | | | |
| 1 | Segregation of duties for some key functions, as well as the presence of a risk monitoring and compliance function | **D** | **D** | There is no formal organizational separation between those responsible for recording and accounting of debt transactions with those responsible for initiating payments. The score remains at D. |

| | | | | |
|---|---|---|---|---|
| 2 | Staff capacity and human resource management | **D** | **D** | Despite competent personnel of the DMD, the score remains D due to the reduced staffing of the DMD which represents a major operational risk for the Treasury. |
| 3 | Presence of an operational risk management plan, including business-continuity and disaster-recovery arrangements | **D** | **D** | The score remains the same. Though the DRBC plan of the MoF is known by staff, the level of staffing of DMD cannot guarantee the minimum level to continue operations. In addition, there is no specific business-continuity and disaster-recovery arrangements for debt management activities. |
| **DPI -14 Debt and Debt Related Records** | | | | |
| 1 | Completeness and timeliness of central government records on its debt, loan guarantees, and debt-related transactions | **A** | **A** | Despite a relative deterioration in the time lag of updating central government debt records (from 1 week on 2012 to 1 month in 2017), debt records are complete for central domestic, external debt in the CS-DRMS. Guarantees being recorded in Excel, due to CS-DRMS technical limitations. |
| 2 | Complete and up-to-date records of all holders of government securities in a secure registry system, if applicable | **C** | **A** | The registry is complete and up to date and is audited on a yearly basis by external auditors and the internal IT auditor audits the system, concentrating on access rights and segregation of duties in the system. It allows for DVP settlement. |

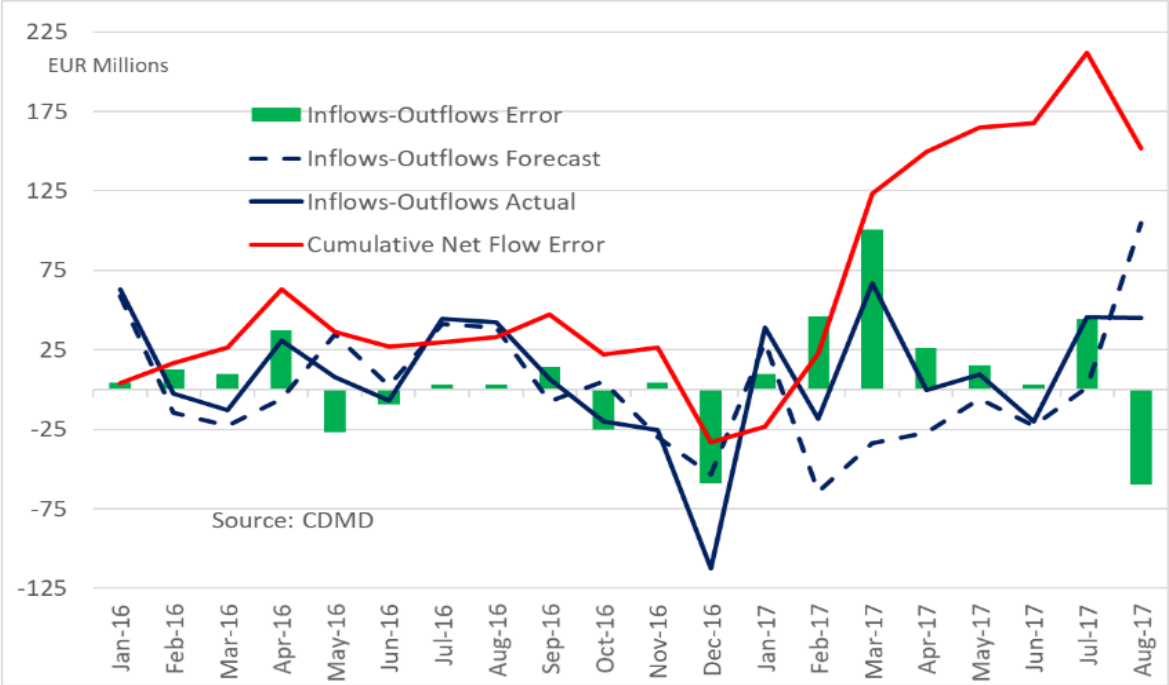
# Annex 3: Cash Management Practices in Kosovo

As requested by the authorities, the mission undertook a detailed review of the cash management practices at the Kosovo Treasury. This annex elaborates on some of the cash management issues discussed at DPI 11 and makes recommendations for future development of the function.

**Cash Flow Forecasting**

The CDMD's has only modest resources to devote to cash forecasting, but (as described in the main text) it has nevertheless established an efficient process to generate monthly cash flow forecasts for the year ahead. The forecasting performance has been creditable. Figure A3-1 illustrates the size of errors in total outflows and inflows since early 2016[19]. There were monthly variations, particularly reflecting uncertainty over the size of the end-year surge in December, but the cumulative error was small until early 2017. Although the inflow forecast has continued to perform well, several factors have reduced expected cash outflows, notably delays in spending on the road to Macedonia. A similar picture is presented in Table 1, which summarises the proportional errors.

**Figure A3- 1: Forecasting Performance: January 2016 – August 2017**




Source: MoF data and staff calculations

[19] A fuller analysis of forecasting performance would need to explore the errors in more detail. The chart shows all inflows and outflows, including financing flows, some of which will reflect decisions made in the light of the forecasts and this may distort the conclusions. It may be that the outperformance in 2017 reflects an element of caution included in the forecasts. In general, the forecast should be an unbiased central case. Decision makers may decide to be cautious or prudent in acting on the forecasts (sensitivities and scenarios play a role in this context), but any allowance for risk should be explicit in order to avoid double counting.

**Table A3- 1: Forecasting Errors, January 2016 – August 2017,**

| Monthly averages | 2016 | | 2017 (to August) | |
|---|---|---|---|---|
| | **EUR million** | **Percent** | **EUR million** | **Percent** |
| **Total Inflows** | 2.8 | 1.9 | 0.4 | 0.3 |
| **Total Outflows** | 5.6 | 2.1 | -22.7 | -16.6 |
| **Inflows - Outflows** | -2.7 | | 23.1 | |

Source: MoF data and staff calculations

The cash flow forecasts rely very heavily on work done within the CDMD. The forecasts, particularly of expenditure, are largely built from past trends or patterns and make only limited use of monthly profiles – which are designed primarily for budget execution not forecasting purposes – prepared by BOs following budget approval. There is more contact with the tax revenue authorities (i.e. Tax Administration and Customs Authority), but they are involved in the processes to update the forecasts each month only on an occasional or as-necessary basis (except at the time of the mid-year review when there is a more complete and formal update).

The CDMD is right to analyse past patterns, rather than trying to build more sophisticated economic models[20]. But it should try to take more advantage of the information available to those in BOs and the tax authorities who are closest to events. They might often be the first to hear of changes in trends or unexpected flows and be best placed to advise, e.g. on project delays or economic developments that might have implications for future tax receipts.

In respect of revenue, both the Tax Administration and Customs and Excise indicated that they could, if asked formally, provide every month a rolling forecast covering the next three months[21]. The CDMD should develop a simple template accordingly. Three months is a minimum, ideally it would be somewhat longer, even extending to the end of the budget year although that might be impractical until after the mid-year revision. The CDMD would ask for a breakdown confined to only the major tax categories; not only is it important to avoid adding unnecessary tasks, the forecasters need only enough detail to be able to understand broad trends. It would have to be stressed that the projections were intended to be

[20] Cash managers elsewhere have found it difficult to develop models that will generate a monthly or quarterly path with any confidence. There are always special factors, such as policy changes, the impact of unseasonal weather in some periods or behavioral shifts to take into account. Some countries have tried to model the underlying trend on which is imposed estimated seasonal adjustments, but the results have not been an improvement on simpler pattern analysis, e.g. monthly averages for 2-4 years. The average may be modified to take account of exceptional circumstances that have distorted the pattern, such as changes from year to year in the day on which a month ends or key holidays fall. A trend factor is added to the average ensuring that the target level for the year is reached as the sum of the monthly forecasts.

[21] In the last months of the year the forecast should extend to the early months of the following year even if the budget has not been formally approved by Assembly although the MoF would have to accept that the numbers would be especially uncertain.

forecasts and not constrained by the budget totals: they should be a forecast of what will happen not what should happen[22].

A similar process could be extended to BOs. But the CDMD needs to be more selective. The exercise could be confined to a handful of large BOs. There is little purpose in collecting information from a mass of smaller BOs when simple pattern analysis would be sufficient. Moreover, information should only be requested for those economic categories which are large and unpredictable. The pattern of salaries is well known and that for, e.g., utilities may be predictable. The focus should be on other goods and services and capital expenditure[23]. It is recommended that the CDMD should start on with, say, two BOs to test the usefulness of the exercise (the current forecast building process should continue in the meantime). Again, the BOs would be asked to complete each month a simple template with a forecast for the following three months or more. The forecasts would be collated and initially used to inform the CDMD's own analysis of the relevant lines; in time, as confidence in the BOs' projections grew, they could replace the relevant components of the CDMD's forecasts[24].

The emphasis must again be on forecasts, not profiling of the budget; forecasting should be as separate as possible from budget execution. That will not be completely possible in a small office such as CDMD, but it will need to stressed to the BOs that their in-year forecasts are not being used as part of the allocation processes, otherwise the effect is to invite game playing, e.g. a reluctance to indicate that the capital budget may in fact be under-executed.

The BOs' forecasts should extend to non-tax revenue, where it is material. Non-tax revenues are currently forecast by the CDMD on the basis of past patterns. That may be sufficient in most cases: the total is small (6 percent of budget revenue in 2016, although running at a slightly higher rate in 2017); most fees and charges are spread across the year, and there appears to be a well-defined pattern for royalty receipts. The CDMD is able to build its own forecast of dividend receipts by contacting the few enterprises that pay dividends.

The completed templates should be supported with informal direct contacts, building on those already made. The figures often needed to be supported by a judgment of whether any divergence from the expected profile is likely to be sustained or reversed. Some countries also insist on prior notice of large payments. That may become necessary when the MoF is managing its cash balance more closely on a weekly or daily basis, as discussed below. But it is probably not an immediate priority in general, although notice or major flows (donor contributions, large project payments) will always be useful.

These direct contacts may be of some help in forecasting the end-year surge of expenditure as BOs rush to ensure that they do not lose any unspent allocations. It is a problem in many countries, particularly those such as Kosovo which do not allow end-year flexibility, whether in commitments or in payments to

[22] The CDMD noted a tendency for revenue projections to be overestimated in the budget preparation process, as forecasts tended to be rounded up to targets.

[23] The CDMD already does request information on major projects, but the suggestion would widen the coverage.

[24] There was some discussion in meetings of the carrots and sticks that some countries operate to encourage BOs to give sufficient attention to cash flow forecasts. No doubt the CDMD will want to keep the options in mind, albeit applying them cautiously,

meet outstanding obligations (which in effect become a prior charge on the following year's allocation) [25]. Some try to give an incentive to bring expenditures forward by reducing allocations if they are not used by a specified date – although this must be accompanied by arrangements for special cases. There may be scope to use the mid-year term review to adjust provisions; and the MoF has powers to cancel allocations in the event of cash pressures. But from the cash flow forecasting perspective, close contact with the relevant BOs is likely to be the best solution.

Several countries have developed a more structured process to endorse the forecasts. Thus, in Kosovo, this might involve the Treasurer or Deputy Treasurer holding a monthly meeting at which the tax administrations (and possibly selected large BOs) would be represented, together with the macro-fiscal functions in the MoF[26]. The meeting would review the forecast prepared by the CDMD with a view to confirming the judgements made, adding any more recent information, or identifying any likely future trends. This process will give the CDMD more confidence in the forecasts as a basis for decision making, as well as stressing the importance of the cash flow forecast to those represented.

In time this meeting would develop into some form of Cash Coordination Committee (CCC). Kosovo is not currently managing cash actively (see next sub-section), but in time the MoF may consider to use T-bills more flexibly with a view to smoothing cash flows somewhat. Forecasts looking at least three months ahead are an essential input to this process. A CCC (at which the CBK would probably also be represented) would review recent market developments, review the forecast and decide the action to be taken over the period immediately ahead. The CDMD would submit the forecasts, with sensitivities and scenarios, and make recommendations for issuance. That is essentially the process that currently supports the preparation of the three-month issuance calendar, but a future CCC is likely to meet more frequently with a focus on T-bill issuance in the following month. A CCC would cover some of the functions of the current Liquidity Committee (although that has not met recently). However, the CCC would link more directly to issuance plans, and should be chaired solely by the MoF.

More active cash management will also require the development of weekly forecasts,[27] initially for the month ahead and subsequently for three months. There is a profile of cash flows within the month (with salaries all being paid at the end of the month), and relatively high cash buffers may be needed to accommodate it. Finer forecasts open up more smoothing options; or they would support cash rationing decisions if that was ever necessary, although one objective of efficient cash management is to avoid the need for cash rationing.

It would be possible now to build a weekly cash flow forecast. The dates of many payments, notably salaries and debt interest, are known as are the dates (or a least date-ranges) for many tax receipts. The tax authorities seen by the mission acknowledged that they could probably develop weekly forecasts or profiles (albeit with a lack of enthusiasm given other work pressures); it should be possible also for the BOs, although the timing of project expenditures would remain uncertain, not least because of

[25] The Ministry of Infrastructure noted that it tried to bring projects to a close in the Autumn leaving time to process payments.

[26] The revenue authorities work primarily with the DEPPFC in the MoF, not the Treasury, although it is kept in touch. The recommendations here imply a closer relationship between the CDMD and the tax authorities; the respective responsibilities with the Macro-Economic Division will need to reviewed.

[27] As would be required to score more highly under DPI 11-1

uncertainty in the timing of donor contributions (BOs often make payments to contractors in advance of donor contributions).

The development of full-scale weekly forecasts is perhaps a lower priority than improving the monthly forecasts. The MoF is yet to issue T-bills every month, let alone more frequently. However, if financial pressures on the MoF become more intense, and cash has to be managed more precisely, then weekly forecasts will be essential. The CDMD must develop some capability accordingly. It is recommended in the first instance to explore how far it can accurately construct a weekly profile, at least for the month or so ahead. That will require extracting past data and maintaining new data on a weekly basis to establish relevant patterns. Requests to BOs and the tax authorities for weekly profiles are perhaps best left until their processes for generating the monthly profiles are well established.

This work may require some strengthening of the IT infrastructure. The process of adjusting allocations and monitoring allocations is already onerous, although the CDMD may be helped by a new module of KIFMIS. It is not advisable to manage cash flow forecasts in a KIFMIS-type system. Data do not have to be of accounting quality, broad brush estimates are usually all that is needed, and the emphasis is on speed and flexibility; it is much easier to do scenarios and what-ifs in excel. One facility that would be of benefit to the CDMD would be an automatic download of outturn data from KIFMIS into the forecast spreadsheet, i.e. linking the respective cells. At the moment, there is a time-intensive process of downloading the data and transferring it to the cells in the spreadsheet. The World Bank team has not been able to explore this possibility with the IT staff, but it is unlikely to present any problems or be costly in terms of IT resources[28]. It should be given priority.

**Cash Management**

There has been limited attempt to smooth cash flows. The CDMD does take the forecasts into account in deciding the issuance programme, and issuance is planned with the intention of the cash balances not falling below the IMF requirement of 4.5 percent of GDP[29].

The fluctuation in cash balances has nevertheless been substantial. Figure 2 illustrates the pattern in recent months[30]. The monthly standard deviation is EUR 46 million.

Excess cash balances carry a cost, represented by the difference between borrowing and lending rates. This difference is currently small. The return on cash at the CBK is zero, but the MoF can borrow domestically short term at less than 0.5 percent; and even the recent 7-year bond had a weighted average yield at issue of just 3.3 percent. However, as international interest rates return towards a historical norm,

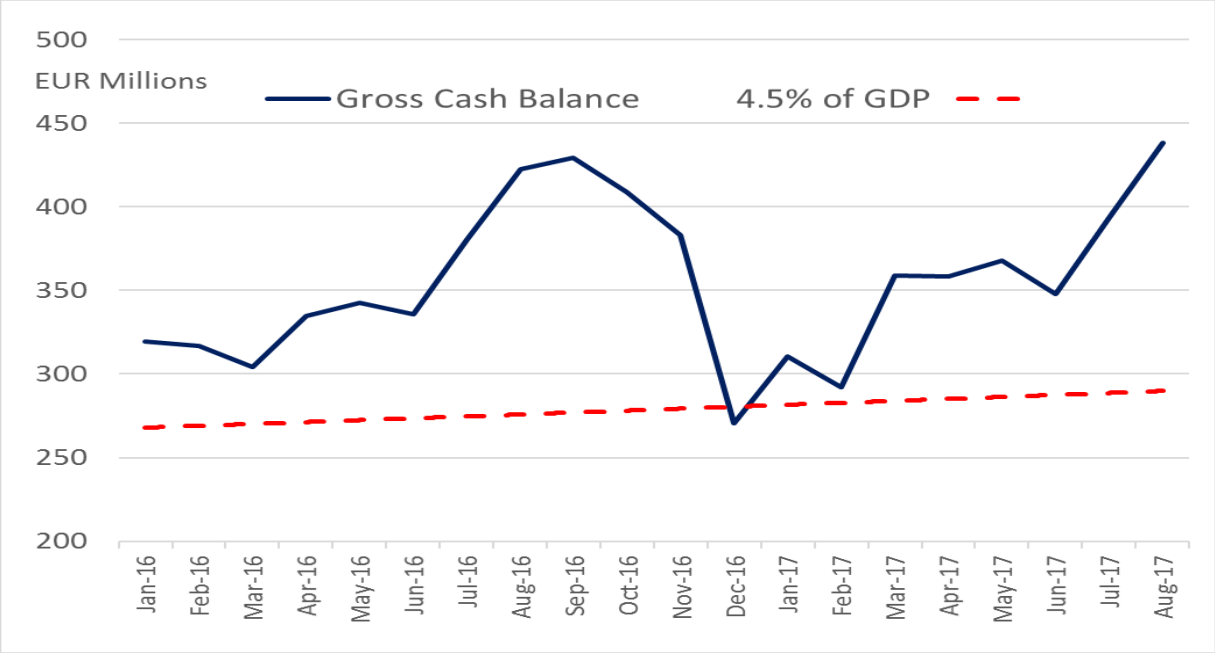
[28] The cash managers of Cabo Verde have recently identified the same need, and the Ministry's IT staff have agreed to put the required links in place in the course of 2017.

[29] This requirement, which includes an element to cope with possible future stress in the banking system, is very high in comparison with international examples, although caution is certainly required in view of Kosovo's vulnerabilities. When the IMF's requirement in relaxed, the MoF will have to make its own analysis of the required cash buffer. Those techniques are not discussed here.

[30] The definition of gross cash balances in Figure 2 is not quite the same as that used by the IMF which nets off certain funds not under direct control of the government. That is unlikely to make much difference to the profile. The GDP trend line has been estimated from IMF and CDMD data.

this differential may increase. A smoother cash balance would allow the MoF to operate with a lower average excess cash balance (while maintaining its buffer), with a net saving[31].

**Figure A3- 2: Gross Cash Balance January 2016 – August 2017**




Source: MoF data and staff calculations

The MoF should develop over time a more active approach to cash management. To some extent this can be achieved through policies to shape the timing of inflows and outflows across the TSA. Thus, salary payments may be spread across a number of days; tax payment days should be designed to coincide with days of expenditure outflow; and redemption dates of loans and securities can be chosen in such a way as to smooth the cash flow impact. But cash flow smoothing usually also means making greater use of short-term borrowing and lending instruments with a view to smoothing the fluctuations in the TSA.

In time, Kosovo should develop a more flexible use of T-bills. Many governments seek to "rough tune" their cash balances by issuing T-bills to a pattern deliberately designed to offset the net cash flows in and out of government. In practice that usually means using shorter-term (1-month or 3-month) T-bills for managing volatility, even if longer-term 6- month or 12-month T-bills are used for deficit financing[32]. Extra T-bills would be issued in months with a prospective low TSA balance and redeemed in months with a high TSA balance. It should be stressed that this approach is entirely consistent with the objective of the debt management strategy to increase the average term to maturity of the debt stock. The aim is not to

[31] In Kosovo, there is not the further benefit, available in countries with an independent monetary policy, of reducing fluctuations in banking sector liquidity, thus taking some pressure off the central bank's monetary policy operations.

[32] Italy and New Zealand are among the countries that issue T-bills with non-standard maturities geared to the days when a cash inflow is expected.

build up the T-bill stock, although it will vary during the year. It is usually also important to explain the approach to the financial market so that there is no misunderstanding on this point.

It is unlikely to be material in Kosovo – in contrast to those countries where there is an independent monetary policy – whether cash balances are held in the banking sector or the CBK. The choice will depend largely on the trade-off between risk and return, although the CBK may have views (either way) about the impact on the inter-bank market. However, any investment in the banking sector whether directly by the MoF or indirectly through the CBK should ideally be collateralised to reduce credit risk[33]. Reverse repo is the best option, although that market has yet to develop in Kosovo[34]. Some countries simply auction deposits periodically, insisting that collateral (usually in the form of government bonds) is available even if the transaction is not strictly structured as a repo.

Active cash management lies in the future. It is too early to develop a comprehensive strategy and timeline. Indeed, the current issuance calendar envisages only one T-bill issue in the third quarter. However, the MoF has stopped issuing 3-month T-bills, the last issuance being in January 2017. The authorities can consider introducing a T-bill program for cash management purposes. It will be much easier to use the T-bills flexibly if they are already in the market, and there is a risk that a sudden introduction might be misinterpreted by the market (although, as noted above, it will be important to explain to the market the government's intention to manage its cash actively as opposed to meeting part of the financing requirement).

**Summary of Recommendations**

In the short term (with a view to starting for 2018), the CDMD should:

- Enhance its forecasts by asking the revenue authorities and a few large BOs to submit each month monthly forecasts (not budget profiles) for the next 3 or more months.
- Support the completed templates with informal direct contacts, building on those already made.
- Establish a regular monthly meeting to review the forecast prepared by the CDMD with a view to confirming the judgements made, adding any more recent information, or identifying any likely future trends.
- Commission the IT department to link outturn data to the forecast spreadsheet to facilitate an automatic download.

In the medium term (ideally in the course of 2018), the CDMD should:

[33] The current requirement in the investment policy that no more than 15 percent of the portfolio should be invested with commercial banks, and that they must be rated as A or higher, is aimed at the same credit risk concerns.

[34] The World Bank team emphasized the importance of developing the repo market in several meetings during the visit. It will be important, not least for the development of market making by primary dealers and of the securities market more generally. The CBK and the MoF are aware of the need and a local master repo agreement has been prepared as a first step.

- Develop internally, on a pilot basis, weekly forecasts for the month ahead, with a view in due course to asking the tax administrations and the large BOs to prepare weekly forecasts.
- Consider a cash management T-bill program, as necessary explaining to the market the intention to use such T-bills more flexibly in future.

## Annex IV. Kosovo: Action Plan – Log Frame

| Issues/ Project Components | Actions | Timing (end-dates) | Expected Outputs of the Actions | Budget | Expected Outcomes of the Project Components | Lead Entity |
|---|---|---|---|---|---|---|
| **1. Organization and Operational Risk** | | | | | | |
| 1.1. Organization of debt management | 1.1.1. Develop internal task descriptions for subdivisions of the DMD (until structure is formalized) | Dec. 2017 | Clarification of roles and responsibilities, and stronger capacity | Internal | The DMD fulfills its mandate in a sustainable manner with strengthened governance arrangements | Treasury/ DMD |
| | 1.1.2. Formalize the front-middle-back office structure in the DMD | June. 2018 | DMD has a stable and formal structure | Internal | | Treasury |
| | 1.1.2. Allocate more staff to DMD | Dec. 2018 | Reduction in operational risks | Internal | | Treasury |
| 1.2. Strengthening debt recording | 1.2.1. Review debt recording processes and procedures (Archiving/Access Control) | Mar. 2018 | Reduction in operational risks | Internal | | DMD |
| | 1.2.2. Add guarantees to the database | Mar. 2018 | Complete debt database | Internal | | DMD |
| | 1.2.3. Upgrade the database | Dec. 2018 | Added functionalities to the database | Internal/ Donor Funding | | DMD |
| 1.3. External borrowing, guarantees, and on-lending | 1.3.1. Review and update procedures for external borrowing | Mar. 2018 | Updated written procedures that reflect practice | Internal/ World Bank | | DMD |
| | 1.3.2 Adopt a methodology for credit risk assessment | Jun. 2018 | Standard credit risk assessment approach | Internal | | DMD |

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| | 1.3.3. Review and update procedures for guarantee issuance | Oct. 2018 | Updated written procedures that reflect practice and the credit risk assessment approach | Internal/ World Bank | | DMD |
| | 1.3.4. Review and update procedures for on-lending | May 2018 | Elaborate written procedures that reflect practice | Internal/ World Bank | | DMD |
| 1.4 Business Continuity Plan (BCP) | 1.4.1 Develop a BCP for debt management activities | Dec. 2018 | Reduction in operational risks | Internal | | DMD/ Treasury |
| **2. Cash Management** | | | | | | |
| 2.1 Improving cash flow forecasts | 2.1.1. Request the revenue authorities and a few large BOs to submit each month monthly forecasts (not budget profiles) for the next 3 or more months | Jan. 2018 - onwards | More frequently updated cash-flow forecast | Internal | The government is better informed on developments on cash-flows, and projections | CMD |
| | 2.1.2. Support the completed templates with informal direct contacts | Jan. 2018- onwards | Enhanced information on cash-flows | Internal | | CMD |
| | 2.1.3 Establish a formal mechanism to review the forecasts | Jan. 2018- onwards | Formalized regular meetings on cash management | Internal | | CMD |
| | 2.1.4 Enhance IT system to link data to the forecast spreadsheet | Dec. 2018 | Automatic download of data | Internal | | IT/CMD |
| | 2.1.4 Move to weekly forecasting for the month ahead | Jun. 2018- onwards | More granular forecast for the near-term | Internal | Enhanced cash-balance management | CMD |
| | 2.1.5 Consider a T-bill program for cash management | Jan. 2019- onwards | Reduced volatility of the cash-balance | Internal | | CDMD |

| 3. Legal Framework | | | | | | |
|---|---|---|---|---|---|---|
| 3.1 Enhancing the Legal framework | 3.1.1 Review the legal framework for debt management and other related areas | Feb 2018 | Identified the need for harmonization with (or exclusion from) other legislation and areas for improvement | Internal/ World Bank | Sound and efficient basis for contracting and managing debt (when enacted) | DMD |
| | 3.1.2 Consult with relevant parties within the government (especially the MFA and the Prime Minister's Office to discuss possible improvements | Apr. 2018 | Solutions for enhancement of legislation | Internal/ World Bank | | Treasury |
| | 3.1.2 Propose amendments in the legislation | Jun. 2018 | | Internal | | Treasury |