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Kosovo

Update of the Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing

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CONTENTS

CURRENCY: EURO

Main Abbreviations and Acronyms

ACCA	Association of Chartered Certified Accountants
AMIK	Association of Microfinance Institutions of Kosovo
BPK	Banking and Payments Authority of Kosovo
CBK	Central Bank of Kosovo
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board (formerly EDCOM)
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IES	International Education Standard
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
KAS	Kosovo Accounting Standards
KFRC	Kosovo Financial Reporting Council
KTA	Kosovo Trust Authority
MEF	Ministry of Economy and Finance
NBFI	Non-bank Financial Institution
PIE	Public Interest Entity
PISG	Provisional Institutions of Self-Government
POE	Publicly-Owned Enterprise
ROSC	Reports on the Observance and Standards of Codes
SCAAK	Society of Certified Accountants and Auditors of Kosovo
SME	Small and Medium-sized Enterprise
SMO	Statement of Membership Obligation
SOE	Socially-Owned Enterprise
SSA	Stabilization and Association Agreement
UN	United Nations
UNMIK	United Nations Mission in Kosovo
UNSCR	United Nations Security Council Resolution

Regional Vice President	Philippe H. Le Houerou
Country Director	Jane Armitage
Acting Sector Manager	Marius Koen
CFRR Head	Henri Fortin
Task Team Leader	Jan Tyl

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Executive Summary

i. This report is an update of the 2006 Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing (A&A) in the Republic of Kosovo (Kosovo). The main objective of the 2006 ROSC was to assist the then-existing Kosovo Provisional Institutions of Self-Government in strengthening A&A practices, in order to support sustained economic growth and improve the competitiveness of local enterprises. For this update, a particular focus was placed on analyzing significant changes in (a) the statutory framework for A&A standards and practices; (b) the A&A profession; (c) the quality of accounting education at the tertiary level; (d) the enforcement of A&A requirements both within the profession and by financial sector regulators; and (e) financial reporting standards in the banking sector. The report also focuses on assessing the degree of alignment of Kosovo's institutional framework for corporate financial reporting with the EU *acquis communautaire*.[1] This ROSC A&A Update will also provide inputs to the Financial Sector Assessment Program (FSAP) Update.

ii. Kosovo is a potential candidate for EU membership and has an estimated population of 1.8 million as of 2010. Its gross domestic product (GDP) per capita is estimated at US$3,059 in 2010. The use of the euro as the *de facto* local currency has sharply reduced exchange rate volatility and has helped keep inflation low. The Kosovo economy is highly dependent on remittances. In the light of the country's ambition to join the EU, this update compares the corporate financial reporting framework in Kosovo with international experience and good practice in accounting and audit regulation, mainly in EU Member States, in order to assess the quality of financial information and to make policy recommendations.

iii. Although consistent support for reforms has been provided by the World Bank, the European Commission and USAID since 2006, the landscape for corporate financial reporting has not changed dramatically since the last ROSC. The most significant change was the passing of a new financial reporting law in July 2011 and an increase in the threshold for statutory audits. Although the new law brings the legal framework closer to the *acquis*, further changes will be required to achieve full alignment with the *acquis.*

iv. In the financial sector, prudential regulations and supervision have been substantially strengthened. A new Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions (the new Law on Banks) was approved in April 2012. There is still no securities market in Kosovo.

v. Kosovo's accounting and audit profession has developed rapidly over the last few years and the national professional body, SCAAK, became a member body of the International Federation of Accountants (IFAC) in 2010. SCAAK faces significant challenges in meeting its obligations as a member of IFAC, especially relating in the areas of ethics, quality assurance and discipline. There has been some progress in integrating accounting education in the

[1] *Acquis communautaire* is a French term referring to the cumulative body of European Community laws, comprising the EC's objectives, substantive rules, policies and, in particular, the primary and secondary legislation and case law – all of which form part of the legal order of the European Union (EU). This includes all the treaties, regulations and directives passed by EU institutions, as well as judgments laid down by the European Court of Justice. The *acquis* is dynamic, constantly developing as the Community evolves, and fundamental. Member States are bound to comply with it (www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/acquiscommunautaire.htm).

universities with professional qualifications; however, more effort is needed in this area.

vi. On the compliance side, the most significant change since 2006 is the improvement within the banking supervisor. Enforcement of accounting requirements among non-banking entities remains a challenge and there has been little improvement since 2006. The financial reporting regulator, the Kosovo Board for Standards on Financial Reporting (KBSFR), which was never fully functional, was replaced by the Kosovo Financial Reporting Council (KFRC) in 2011. No significant change, however, was made to the operating model of the regulator and, unless this is addressed, there is a distinct possibility that KFRC will follow in the footsteps of KBSFR. Steps have yet to be taken toward establishing a quality assurance system consistent with the EU Statutory Audit Directive.

vii. The 2006 ROSC A&A set out a series of recommendations. To date, many of these recommendations have not been acted on, and most of those that have been implemented still need additional work.

Summary of Recommendations

viii. While all the policy recommendations set forth in Section VI of this report are important, there are several overriding themes, which the ROSC team considers to be "critical success factors" for the development of reliable and efficient financial reporting infrastructure, economic growth (including the mobilization of investment capital) and the fight against corruption.

ix. These critical success factors are based on four underpinning principles as follows:

- ***Clarity of reform objectives*** – for the alignment with the *acquis* effort to succeed, it is critical that the gaps are identified and appropriately addressed by amending relevant legislation. The ROSC team has prepared preliminary draft concordance tables to be discussed with the Ministry of Economy and Finance (MEF);
- ***Effective implementation*** – amending the legislation will not resolve the challenges in itself. The legislation needs to be implemented and enforced and an official should be designated to oversee and coordinate the reform process;
- ***Institutional capacity*** – institutions designed to supervise and enforce compliance with the law need to be adequately staffed and technically competent. "Competence" in this context includes the ability to understand and interpret the relevant international standards and regulations applicable in Kosovo.
- ***Alliances*** – where capacity needs to be strengthened, stakeholders need to work together in order to achieve the desired results.

x. Based on these principles, short- and medium-term priority actions have been identified and are summarized in the table below. In order to successfully address them, an action plan containing the next steps would be very helpful. Regional REPARIS provides one platform, where such a plan could be formulated and discussed, drawing on the experiences of other countries in the region, including Croatia (which has achieved alignment with the *acquis* in this area).

Objective	Recommended Short- to Medium-Term Priority Actions and Institutional Arrangements	Leading Institution(s)
Develop a strategy to improve the financial reporting infrastructure in Kosovo	Use concordance tables to identify the differences between the current law and the *acquis communautaire* (drafts have been prepared by the ROSC team), designate an official responsible for the reform, and amend the law to align it with the *acquis*.	MEF, KFRC SCAAK and donors
	To ensure a timely follow-up of this ROSC Update, seek support of donors to assist with the concordance table completion and drafting the required amendments.	
	With the assistance of donors, retain experts to assist in preparing and implementing changes to the law.	
	Clarify which accounting standards apply to which type of business entity.	
	Take initial steps toward establishing a sustainable quality assurance system for the statutory audit function.	
Develop a transparent financial reporting regime conducive to foreign investment	Revisit the requirement to publish financial statements to ensure that the institution assigned the task of collecting the statements has the capacity to effectively enforce the requirement. Consider assigning the task to the Kosovo Business Registration Agency.	MEF
	Design a strategy, with the assistance of donors, to improve the performance, functionality and capacity of KFRC.	MEF, KFRC and donors
Strengthen accountancy education system	Promote the integration of university and professional education.	MEF, universities, SCAAK
	Update and enhance the quality of tertiary-level accounting education.	Universities
	SCAAK should share its resources with the universities and, at a minimum, part of the training program for accounting technicians should be devolved to universities.	SCAAK

A key long-term goal for Kosovo is to have a robust and effective audit quality assurance and disciplinary and sanctions systems in place. As an IFAC member, SCAAK should play a leading role in this, in collaboration with the KFRC.

I. Background

I.A ROSC Program

1. This assessment of accounting and auditing practices in Kosovo is part of a joint initiative of the World Bank and International Monetary Fund (IMF), to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment should focus on the strengths and weaknesses of the accounting and auditing environment, and how those influence the quality of corporate financial reporting. It involves a review of mandatory requirements and actual practice, using International Financial Reporting Standards (IFRS)[2] and International Standards on Auditing (ISA)[3] as benchmarks. It draws on international experience and good practice in accounting and auditing regulation. The assessment also has regard to the relevant requirements of EU laws (the *acquis communautaire*).

2. Since its inception in early 2000, the ROSC Accounting and Auditing (A&A) program has concluded evaluations of the A&A environment in more than one hundred countries around the world including all but one countries of the Europe and Central Asia Region. The ROSC A&A initiative has, in general, two major purposes:

- To evaluate the quality of national A&A standards, mainly by comparing them with IFRS and ISA, and by assessing compliance with those standards.
- To assist the country in developing an action plan for improving the institutional framework that underpins its corporate financial reporting and auditing regime

To meet these objectives, the scope and application of the standards need to be assessed in the framework of the country's overall development strategy, and recommended improvements need to be tailored to the country's specific circumstances.

3. **This assessment is an update of the first A&A ROSC for Kosovo, which was published in June 2006.**[4] Therefore, the primary objective is to capture and describe the progress achieved since then, particularly as regards the implementation of international standards and good practice, as well as the degree of Kosovo's alignment with *the acquis* in relation to financial reporting.

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[2] International Financial Reporting Standards are issued by the International Accounting Standards Board (IASB), an independent accounting standard-setter based in London, United Kingdom. The IASB announced in April 2001 that its accounting standards would be designated "International Financial Reporting Standards" (IFRS). Also in April 2001, the IASB announced that it would adopt all of the International Accounting Standards (IAS) issued by the International Accounting Standards Committee (IASC). Within this report, the term IFRS encompasses both IFRS and IAS as well as the related interpretations.

[3] International Standards on Auditing (ISA) are the standards issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants (IFAC).

[4] The 2006 ROSC A&A is available at: http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/EXTCENFINREPREF/0,,contentMDK:21569478~menuPK:7356128~pagePK:64168445~piPK:64168309~theSitePK:4152118,00.html

I.B Economic Context

4. **Kosovo is landlocked and borders the Former Yugoslav Republic of Macedonia to the south, Albania to the west and Montenegro to the northwest. The remaining frontier belt is with central Serbia and remains the subject of dispute.** The largest city and the capital of Kosovo is Pristina (alternatively spelled Prishtina or Priština). The name Kosovo has represented a number of different entities with different borders over the centuries. There have also been periods when no political entity has existed with the name of Kosovo. Today's outline dates back to 1946.

5. **Following the end of the Kosovo war of 1999, the United Nations Security Council Resolution (UNSCR) 1244 placed Kosovo under temporary UN administration (UNMIK). A declaration of independence was adopted on 17 February 2008 by the Assembly of Kosovo.** In July 2010, by a ten-to-four vote, the International Court of Justice issued an advisory opinion that the declaration was not in violation of international law and stating that "the Court thus arrives at the conclusion that, taking all factors together, the authors of the declaration of independence of 17 February 2008 did not act as one of the Provisional Institutions of Self-Government within the Constitutional Framework, but rather as persons who acted together in their capacity as representatives of the people of Kosovo outside the framework of the interim administration."[5] As of February 16, 2012, 87 UN member countries have recognized Kosovo.[6] On 29 June 2009, Kosovo became a full member of the World Bank and IMF.[7]

6. **As of 2011, the population of Kosovo was estimated at 1.8 million, of which 45% lived in urban areas. With a GDP per capita of EUR 2,368,[8] Kosovo is one of the poorest countries in Europe;[9] and its income levels are about two-thirds of other countries of the Western Balkans.** Poverty remains widespread but has been declining − according to the latest available data (from 2009), 34% of the population is living below the national poverty line, and an estimated 12% are extremely poor. Extreme poverty is disproportionately high among children, the elderly, households with disabled members, and female-headed households. However, the narrowness of the poverty gap suggests that poverty is not deep. With a 45.4 percent official unemployment rate and a very low employment rate (26.4%), Kosovo has the weakest employment track record in Europe, and its labor force participation rate among the working age population (48.1%) is substantially below the average for all transition economies (65%).

7. **Kosovo's economic growth has been steady since the end of the conflict in June 1999, attributable in part to large public investments in post-conflict reconstruction as well as an increase in private consumption and investment (albeit from a very low base).** Growth slowed from 6.9 percent in 2008 to about 2.9 percent in 2009, and recovered to 4 percent in 2010

[5] http://www.icj-cij.org/docket/files/141/15987.pdf
[6] http://en.wikipedia.org/wiki/International_recognition_of_Kosovo
[7] http://www.state.gov/r/pa/prs/ps/2009/06a/125489.htm
[8] The census from April 2011 revealed that population of Kosovo is smaller than previously estimated. This brings a higher GDP per capita than estimated before the census.
[9] World Bank – Kosovo Partnership Program; Snapshot September 2011

in the wake of the global economic crisis – this is a much better outcome than for the rest of Southeast Europe, which mostly suffered declines in output. The relatively small impact of the global financial and economic crisis on real growth up to this point reflects Kosovo's limited integration with the global economy.

8. Use of the euro as the de facto local currency has eliminated exchange rate volatility and kept inflation at a low level. However, Kosovo's economy is highly dependent on remittances. The external sector experienced a worsening trade balance in 2011. Imports of goods were expected to increase by 13.2%, while exports of goods were expected to increase by 10.5%. These developments contributed to increasing the trade deficit as a ratio to GDP by 1%, from 40.8% in 2010 to 41.8% in 2011.[10] On official estimates remittances constitute 15% of GDP. However, by some estimates, the total flow of remittances amounts to 30% of GDP. The likely impact of the current European sovereign debt and banking crises on Kosovo is given in Box 1. In short, the expectation is that official aid, external bank lending, foreign direct investment and remittances from abroad will be reduced over the next couple of years as a result of the broad economic slowdown in Europe.

9. **The vast majority of Kosovo's 90,000 businesses are microenterprises with limited access to external financing.** Where external financing is extended to a business, the decision is ordinarily not based on the assessment of financial statements and repayment capacity, but, rather, on the quality and value of the collateral provided by the borrower.

10. **Sound, reliable financial information is fundamental for moving away from the collateral-based lending model, toward cash-flow lending or credit-scoring, both of which depend on the lenders' ability to obtain transparent and accurate financial data.** The quality of accounting and auditing practices in an economy like Kosovo is important for both the private and public sectors, in that both play an important role in driving the country's growth.

11. **Since the 2006 ROSC was issued, the role of the banking sector has changed significantly relative to the financing of the Kosovo economy.** It is still true that small private enterprises are typically funded by retained earnings and informal, family-generated funding. Loans to the private sector stood at 10% of GDP in 2003 and 23% of GDP in 2005. That ratio grew to 33% in 2009; in June 2011, the total value of loans issued by the banking system in Kosovo stood at EUR 1.6 billion (34.3% of GDP).[11] Kosovo's banks remain liquid; their deposit-to-loan ratio was 181% at the end of 2004 and 133% in November 2011[12], providing a strong enough refinancing base for further expansion of their loans' portfolio. At the end of 2011 there were eight banks operating in Kosovo. As was the case in 2006, two of these, whose majority shares are owned by foreign banks, owned the majority of banking assets. Only two banks are owned by local shareholders, one foreign bank maintains only a branch in Kosovo. The banks are not involved in complex financial transactions and this helped them to avoid many of the recent difficulties of the global banking sector. The Central Bank requires the banks to follow, more or less, Basel I capital requirements. There are no investment banks or funds in Kosovo.

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[10] Macroeconomic Review No. 6 (July – September 2011) , Ministry Of Finance
[11] http://bqk-kos.org/repository/docs/2011/Financial%20Stability%20Report%20No.%202.pdf
[12] Central Bank of Kosovo Monthly Statistics Bulletin, November 2011

Box 1: Impact of the Current European Crisis on Kosovo

The crisis in the eurozone increases the economic headwinds facing Kosovo, even though it is not a member of the single currency area. Kosovo is expected to be affected in the following ways:

- **Many members of the eurozone have had to adopt austerity programs, increasing tax levels and reducing levels of government spending.** This has contributed to a weakening of economic activity in the EU, which has led to a reduced demand for exports from Kosovo and a reduction in the flow of remittances to the country. Austerity measures will also have an adverse impact on flows of donor aid which still make up a significant segment of receipts for the government budget in Kosovo.
- **In addition, due to losses on many of their assets, including holdings of sovereign bonds, many euro zone banks are seeking to strengthen their capital positions.** This affects not only banks in the countries which have applied for assistance from the EU and IMF, but also large banks in Germany, France, the Netherlands and other EU centers of finance. As a result, many euro zone banks are reconsidering their levels of exposure to markets outside their home country. Given that banks from the euro zone are the largest bloc of capital providers to Kosovo banks, any reduction in the activity of such banks is likely to have a dampening effect on Kosovo's economic growth in the near to intermediate term.

12. **At the end of 2011, thirteen licensed insurance companies had operations in Kosovo; of these, 10 were non-life insurance and three were life insurance companies.** The separation of life and non-life insurance is a legal requirement. In general, the insurance sector remains underdeveloped, with the majority of premium revenue (70%) originating from third-party liability insurance (premium rates are set by the Central Bank of Kosovo - CBK). As of September 2011, the total technical reserves[13] of all insurance companies in Kosovo stood at EUR 52.6 million, and the total annual profit for the sector was EUR 2.7 million.[14]

13. **Microfinance institutions (MFIs) have recently provided significant capital to small businesses.** There are 15 MFIs in Kosovo, of which 11 are NGOs and 4 are joint stock companies (the NGO status is a relic of the 1999 post-war period in Kosovo, when all MFIs were required to be registered first as NGOs). Twelve MFIs are members of the Association of Microfinance Institutions of Kosovo (AMIK). According to AMIK, the entire portfolio of MFI credits is about EUR 90 million, and the clientele consists of 60,000 businesses. MFIs make up approximately 5% of the financial sector in Kosovo in terms of assets, and their combined loan portfolio is around 15% of total lending in Kosovo. The largest MFI is KEP Trust (KEP). KEP started its activities in 1999, as a project of the Swiss-based International Catholic Migration Commission (ICMC). Its aim was to provide credit to small and micro enterprises, initially focusing on businesses of Kosovo refugees returning after the end of the conflict.[15] KEP's portfolio is about EUR 30 million, allocated to more than 18,000 clients; the company has 34 branches and over 320 employees. In addition to MFIs, the financial sector includes 4 money transfer agencies, 30 exchange bureaus and 5 non-bank financial institutions.[16]

14. **Given their importance to the economy, MFIs are also regulated by the new Law**

[13] The technical reserves held by insurance enterprises consist of the actuarial reserves against outstanding risks in respect of life insurance policies, including reserves for with-profit policies which add to the value on maturity of with-profit endowments or similar policies, prepayments of premiums and reserves against outstanding claims (OECD definition).
[14] Central Bank of Kosovo Monthly Statistics Report Nr. 123
[15]http://keptrust.org/?cid=2,27
[16] Central Bank of Kosovo - http://bqk-kos.org/?cid=2,7

on Banks. The law differentiates between "registered MFIs" and "licensed MFIs"; the difference relates to the extent that time and savings deposits can be accepted by the MFI. The new Law on Banks stipulates that no MFI can operate in Kosovo unless it is registered or licensed by the CBK. The law lists specific conditions that must be met for an MFI to be registered, licensed and, where appropriate, to have its license or registration cancelled. The law also lists activities that are permitted and stipulates the MFIs can operate as NGOs or joint-stock companies. Prudential requirements include a minimum level of capital (EUR 200,000), and a ban on credits to management and related parties (if such credits are extended, the amounts are deducted from the capital for prudential reporting purposes). Total liabilities may not exceed 500% of equity. MFIs must maintain their records in accordance with IFRS.

15. Some MFIs are large enough that their operations have approached the scope of commercial banks, and governance issues have arisen in at least one case (involving management abuse of administered funds). For this reason, some of the larger MFIs are considering applying to the CBK to become banks. Such a change is permitted by the new Law on Banks, subject to possible retroactive taxation by the Tax Administration of donated capital and retained earnings. The transformation requires the initial registration of a joint-stock company with the clear identification of the future owners and their residence (NGOs do not have shareholders or owners).

16. **One licensed, supplementary pension fund was in operation at the end of 2011 – the Sloveno-Kosovan Pension Fund (SKPF).** Since the previous ROSC Report, the licenses of seven other supplementary pension funds have been revoked and/or cancelled, and their funds were transferred to either SKPF or the public pension fund. SKPF was established in September 2006 and licensed in November 2006 by the CBK. The founders are Prva Group of Slovenia and Dukagjini Corporation of Kosovo. The Prva Group asserts on its web pages that it serves 274,041 individuals, and that it has EUR 317.296 million of assets under management and EUR 32 million of capital as of November 30, 2011.[17] These totals, however, relate to the entire Prva Group operations (in Slovenia, Serbia, Romania, Albania, FYR Macedonia and Kosovo). The SKPF itself has approximately 4,000 members and EUR 4 million in assets (the minimum required by law). The SKPF took over two other failed funds in 2008 and currently administers two funds, one comprising retired members, the other comprising members prior to retirement. As yet, Kosovo has no capital market.

17. **The enterprise sector in Kosovo is currently comprised of three types of entities: (i) privately-owned enterprises, which account for the majority of the sector (by number and share of output); (ii) publicly-owned enterprises (POEs); and (iii) socially-owned enterprises (SOEs).** The distinction between POEs and SOEs - which together form the public enterprise sector – is rooted in the commercial legal regime of the Socialist Federal Republic of Yugoslavia (SFRY)[18], which was reinstated in Kosovo by UNMIK in December 1999.[19] Under that regime, POEs corresponded roughly to the state-owned enterprises of other socialist countries; however, social ownership was a concept unique to the SFRY, in which

[17] http://www.prvagroup.eu/en/members.asp?FolderId=343

[18] i.e., the regime in place prior to 1989.

[19] UNMIK Regulation 1999/24 - the legal definition of POEs and SOEs is given in the Law on Enterprises of the SFRY 77/88.

enterprises were owned not by the state but by workers. UNMIK exercised the power to regulate and manage all POEs and SOEs until the Kosovo Trust Agency (KTA) was formed in 2002 as an autonomous agency. The KTA then took over responsibility for the POEs and SOEs.[20] The KTA also become responsible for the process of privatizing the SOEs, which was begun in 2003. POEs were not included in this privatization process.

18. **In 2008, the Privatization Agency of Kosovo (PAK) was established (by Kosovo Law No. 04/L-034 on the PAK) as the successor of the KTA.** PAK is an independent public body and its primary mandate is to privatize or liquidate all remaining SOEs. All assets and liabilities of the KTA were transferred to the PAK. Those SOEs designated for privatization are sold by way of public tender in “waves.” At the end of 2011, 53 such waves had been completed and the vast majority of SOEs had been sold. In general, PAK creates NewCo's from SOEs and then offers for sale assets and current liabilities. Investors only bid for the assets - and only a few of the current liabilities – of the NewCo, not those of the original SOE itself. PAK sometimes breaks SOEs into several smaller NewCos. Those SOEs deemed unfit for privatization are liquidated by way of the sale of assets. At the end of 2011, 10 such liquidation asset sales had been completed. Total proceeds from liquidation sales and privatization were EUR 31,399,356 and EUR 517,231,073 as of 31 March 2011.[21]

19. **On June 13, 2008, the Assembly approved Law 03/L-087, On Publicly Owned Enterprises. The Law lists 30 POEs in total and classifies them into four categories: Central POEs (6 enterprises), Regional Water POEs (6), Regional Irrigation POEs (2) and Local POEs (16).** While the regional and local POEs include water, waste and heating companies of little economic significance, the central POEs include much larger entities, such as the Kosovo Energy Corporation, Transmission System and Market Operator, Post and Telecommunications of Kosovo, Kosovo Railways and Pristina International Airport (in accordance with the agreement between UNMIK and the Government of Iceland (GOI), the GOI is responsible for ensuring that air traffic control operates in accordance with the rules of the International Civil Aviation Organization).

20. **Foreign direct investment (FDI) inflows to Kosovo for the first three quarters of 2010 totaled EUR 203 million, an amount comparable to 2009. This is well below the 2007 annual high of EUR 414 million.** The leading investors came from Germany, Slovenia and Switzerland; there were also smaller inflows of investment from Austria, Great Britain, Turkey, the Netherlands, Albania, the US and France. The main sectors attracting FDI were financial services, manufacturing, construction, processing industries and real estate.[22] Despite some success in attracting new investors, the level of FDI inflows has stagnated in recent years. As a result, the trade balance has actually worsened in recent years, and the official unemployment rate remained at approximately 45%.[23]

21. **This report assesses the quality of financial reporting only of selected POEs and**

[20] http://www.kta-kosovo.org/ktareg/UNMIK%20Regulation%20No.%202002-12%20Establishing%20the%20KTA.pdf
[21] Quarterly Report on Activities of PAK, 18 April, 2011
[22] www.balkaninsight.com.
[23] The World Bank - http://siteresources.worldbank.org/KOSOVOEXTN/Resources/Kosovo_Snapshot.pdf.

private entities, and compares the findings with those in the 2006 ROSC report. This comparison then enables recommendations for improvement.

II. Accounting and Auditing Framework: Main Changes Since 2006 [24]

II.A Statutory Framework

22. **This report addresses changes in financial reporting by corporations (i.e. companies in which shareholders have limited liability) as well as by POEs and SOEs (Para. 17) since the 2006 A&A ROSC.** The formation and regulation of business entities in Kosovo is governed by law No. 02/L-123 On Business Organizations (the Law on Business Organizations), which was approved by the Assembly in 2007 and succeeded UNMIK Regulation 2001/6 (2001) on Business Organizations. While the UNMIK Regulation provided a set of principles to be followed by business organizations, the Law on Business Organizations is much closer to a full-fledged commercial code. The Law on Business Organizations (similarly to the UNMIK Regulation) sets out that a business organization may be established as a personal business enterprise, a general or a limited partnership, or a corporation. A corporation may be incorporated as a joint stock company or a limited liability company:

- A joint stock company is a corporation, which may have any number of shareholders, as well as different classes of shareholders. It may conduct a public offering of its shares, and the owner(s) may transfer his/her (their) shares without the approval of other shareholders or of the company. The minimum initial capital of a joint stock company must be at least EUR 25,000 (unchanged from the UNMIK Regulation requirement). The general meeting of shareholders is the ultimate governing body of a joint stock company. The board of directors is responsible for ensuring compliance with applicable laws and accounting standards. The law further requires the Board to ensure that the annual report contains "an independently audited statement of the company's financial position," which seems to require that annual reports of joint-stock companies include the audited balance sheet only.[25]
- A limited liability company is a corporation, the shares of which are distributed only to its founders or among other pre-determined persons. The number of shareholders was limited to 50 under the UNMIK Regulation; this limitation has since been abolished. A limited liability company cannot conduct a public offering of its shares. Restrictions on transfer of ownership have been loosened: while the UNMIK Regulation gave existing shareholders a right of first refusal but permitted the company agreement to state otherwise, the Law on Business Organizations permits transfer of ownership to anybody, but permits the company agreement to include a right of first refusal. The governing body of a limited liability company is also a general meeting of its shareholders. The Law on Business

[24] This report outlines the legal principles applicable with regard to accounting, auditing and financial reporting and does not attempt to give anything more than an introduction to the issues. This report is not meant to be an exhaustive rendition of the law nor is it legal advice to those reading it.
[25] Law No. 02/L-123 On Business Organizations, Para 169.2b

Organizations abolished the provision of the UNMIK Regulation that required limited liability companies with more than 20 shareholders to appoint a board of directors.

- The banking and insurance laws require banks and insurance companies to be incorporated as joint stock companies. Because of the nature of their activities, this report regards these financial institutions as *public interest entities.*

23. **The Kosovo Financial Reporting Council (KFRC) is the successor to the Board on Standards of Financial Reporting (KBSFR); it was established in 2011 under Law No.04/L–014 On Accounting, Financial Reporting and Audit (the Law on Financial Reporting).** As a super-regulator, the KFRC is the standard-setter for accounting, auditing, ethics and professional audit education, regulator, and enforcer. KFRC's mandate is identical to that of the KBSFR. However, the KBSFR always lacked the capacity to exercise its regulatory authority, which resulted in the significant implementation challenges noted in the 2006 ROSC. There is a need for an honest assessment of the KFRC as it is not clear that it will have the capacity to address the regulatory challenges that it faces. This report includes proposals to address the difficulties experienced by the KBSFR that may also affect the KFRC. The Law on Financial Reporting establishes the framework for accounting and auditing in Kosovo and makes the KFRC responsible for the following:

- setting accounting and auditing standards for business organizations; however, this authority does NOT include the financial sector;
- setting the accounting and auditing requirements for the financial statements of business organizations including corporations established under the Law on Business Organizations, SOEs, and POEs, though not for the financial sector;
- establishing and issuing standards for the professional training of accountants and auditors, leading to the certification of accountants and the licensing of auditors; however, the law delegates the regulation of accountants to licensed professional associations; and
- reviewing applications for and issuing audit licenses to individuals and firms, as well as the licensing of professional associations (currently, the Society of Certified Accountants and Auditors of Kosovo is the only licensed professional association).

To discharge all these responsibilities, the KFRC must have an extensive technical expertise at its disposal. Currently, the KFRC does not possess such expertise.

24. **Over the years, the KBSFR received some technical assistance as part of donor-funded projects addressing broader issues than financial reporting. This has allowed modest progress to take place, but the KFRC has yet to fully discharge all of its responsibilities.** Without a functioning standard-setter and regulator, the Kosovo financial reporting regime has not been able to play any role in attracting inflows of FDI. The KFRC held its first meeting in the late 2011; and it is not yet clear whether it can develop the capacity to address its predecessor's shortcomings. The Law on Financial Reporting added another major responsibility on KFRC, namely, collecting and publishing the financial statements of entities subject to the requirement to file financial reports. The Law, however, still leaves the KFRC within the MEF (this means that the employees of KFRC are subject to public-sector salary scales) and maintains the provision of the previous law that fees and fines collected by the

KFRC are revenues of the budget.

25. **This configuration did not work well for the KBSFR during its almost ten years of existence and is not likely to work for the KFRC. Therefore, we recommend that the KFRC would benefit from a change in this aspect of its organizational structure. This would enhance its capacity to create the financial reporting infrastructure needed to support direct foreign investment.** Such a change could be achieved through one of the following options: (i) the KFRC becoming a self-financing agency, responsible for collecting and administering fees and fines, which could employ experienced professional accountants and/or auditors in its office at market rates; (ii) maintaining the status quo, but increasing significantly KFRC's budgetary appropriation so as to provide it with the resources needed to function effectively; or, (iii) a combination of (i) and (ii). Options (i) and (iii) would require an amendment of the law.

26. **The Law on Financial Reporting was approved in 2011; its drafting and approval took almost seven years (according to the previous ROSC Report the law was "in the process of being amended" In 2006).** As was the case under the UNMIK Regulation, financial institutions are specifically excluded from application of the Law on Financial Reporting and are subject to regulation by the CBK instead. The new law was expected to contribute to the alignment of the corporate reporting framework with the *acquis*. Although, it fell short of this objective, the new law does represent an improvement on the UNMIK Regulation, and the salient points are described below.

27. **Business organizations are currently classified as large, medium, small and micro on the basis of the following criteria:**

Type of organization	Turnover	Gross assets	Average number of employees
Large business organizations (two out of three)	higher than EUR 4 million	higher than EUR 2 million	in excess of 50
Medium business organizations (two out of the three)	higher than EUR 2 million	higher than EUR 1 million	more than 10
Small business organizations (two out of three)	higher than EUR 50,000	higher than EUR 25,000	up to 10
Micro enterprises	lower than EUR 50,000	lower than EUR 25,000	fewer than 10

28. Large business organizations will have to apply, starting from 2013, IFRS, as well as interpretations, recommendations and necessary guidance that are approved by the KFRC. All medium and small business organizations registered as limited liability companies or joint-stock companies will also be required to apply IFRS as approved by the KFRC. The wording of the law raises a question as to whether the IFRS for SMEs could be imposed by the KFRC on medium and small enterprises, thereby alleviating some of the regulatory burden on these

companies, or whether full IFRS must be applied by small companies. The KFRC has indicated that it is currently working with the MEF to amend the law so that the IFRS for SMEs will be applicable in Kosovo at some date in 2013.

29. **The Law on Financial Reporting is silent on the use of Kosovo Accounting Standards (KAS), although it holds the KFRC responsible for maintaining KAS. This has created confusion.** The law specifies that consolidated financial statements of all business organizations should be in accordance with 78/660/EEC (this is a reference to the "Fourth Directive" while the "Seventh Directive" on consolidated accounts is not mentioned) and IFRS.

30. Financial statements of large and medium business organizations must be audited, with the applicable auditing standards being ISA. The calendar year is also the fiscal year for all business organizations. The previous ROSC Report noted that the scope of statutory audit requirements was "too broad in Kosovo considering the stage of development of the audit profession." In this respect, the new Law on Financial Reporting represents a significant improvement. Under the UNMIK Regulation, financial statements of all corporations with annual turnover or total assets greater than EUR 250,000, as well as all POEs and SOEs were subject to statutory audit; however, the new law limits the requirement to large and medium business organizations.

31. **Shareholders of non-financial companies subject to an audit requirement appoint the auditor from among the auditors licensed by the KFRC. The appointment of a bank or insurance company's auditor is subject to CBK approval.** That approval is based on the following conditions:

- The sole practitioner or audit firm must have been duly licensed by the KFRC. A foreign audit firm is eligible for licensing by the KFRC, if at least two of its local partners are auditors licensed in Kosovo.
- The approval is granted for a given financial institution's audit in a given year, i.e. an audit firm/sole practitioner may be approved as the auditor of several financial institutions, but it is necessary for separate approvals to be granted to that firm for the audit of each financial institution for that financial year.
- The audit firm/sole practitioner must provide the CBK with (i) a program for the audit of the financial institution, and (ii) a description of the resources to be used for the audit mission.
- In practice, financial statements of all banks and insurance undertakings are audited by the local member firms of major international audit networks (Big Four plus Grant Thornton).
- There is a five-year firm rotation requirement for auditors of financial institutions. This requirement is applicable to both sole practitioners and firms, as the regulation does not distinguish between the two.

32. **Filing of annual company financial statements is required by law, in line with the EU *acquis*.** Article 11 of the Law on Financial Reporting requires that, "Financial statements of large business organizations have to be submitted to and published by the KFRC and a copy

submitted to the Ministry of Trade and Industry (MTI) which hosts the Business Registry, no later than 30 April of the following year." Further, consolidated financial statements have to be submitted to the KFCR and a copy sent to the MTI, no later than 30 of June of the following year. This requirement is similar to the requirement in the UNMIK Regulation, which imposed the obligation on all business organizations to file financial statements with the business registry and the Ministry for Economy and Finance (MEF). As was noted in the 2006 ROSC Report, this requirement is still widely ignored and is not effectively enforced. Continued non-compliance with the filing requirement contributes to the overall lack of transparency and trust in the business environment.

33. **The filing requirement in the Law on Financial Reporting does not specify the agency at MTI to which the financial statements should be submitted; neither does the law provide guidance as to how the KFRC should arrange for the collection of those statements, given its current lack of capacity.** Staff at the KFRC have been working to improve the situation and have achieved some successes. Still, with the exception of the financial institutions governed by the CBK, the financial statements of many Kosovo companies, including POEs and SOEs (Airport Pristina and Post and Telecom of Kosovo are notable exceptions) are not publicly available. This situation is inconsistent with *the acquis;* and the resulting lack of transparency is not conducive to attracting foreign direct investment.

34. **Law No. 03/L-074 On the Central Bank of the Republic of Kosovo (the Law on the CBK) replaced the relevant UNMIK Regulation in 2008. The Law on the CBK contained a specific reference to standards setting: "… to set accounting standards for the financial institutions in Kosovo in line with international financial reporting standards." In 2010, however, the Law on the CBK was replaced by Law No.03/L –209 On the Central Bank of Kosovo (the new Law on the CBK).** The new Law on the CBK does not include a reference to the mandatory application of IFRS by banks; instead it states in Article 23 that, "Financial institutions shall furnish the Central Bank with such information and records concerning their operations and financial condition as the Central Bank may require." However, the IAS/IFRS requirement was also specified in UNMIK Regulation No. 1999/21 for the licensing, regulation and supervision of the banks, and the new Law on Banks refers, in Article 53, to "internationally-accepted" accounting standards as applicable to Kosovo banks.

35. **Financial statements of all banks are available on their websites.** The requirement that banks publish their financial statements is not clearly specified by law and it is a good example of transparency in Kosovo that they do so.

36. **Banks are required to produce the following prudential reports:**

- Weekly reports on liquidity reserve maintenance at the CBK;
- Monthly reports, including a computation of liquidity reserves; balance sheet; statement of income; summary of classified assets and provisions; report on deposits, loans, and wire transfers; report on cash imports and exports; statistical report on balance sheet items; statistical report on interest rates; and a report on international transactions;
- Quarterly Reports including assets and other liabilities; changes in capital and reserves; other income and expenses; receivables overdue more than 90 days (non-performing

assets) and other overdue assets; credit concentration; credit exposure to insiders; balance sheet maturities; funding concentration; off-balance sheet items; capital base risk-weighted assets; interest rate risk exposure; foreign exchange positions; and pay instruments; and

- Annual report - any bank or branch of a foreign bank should submit a copy of its Annual Report to the CBK within 120 days of the end of its financial year. The Annual Report includes its balance sheet, statement of income, supporting notes and schedules, and the auditor's opinion and management letter for the preceding financial year.

The CBK may, on an *ad hoc* basis, increase the frequency of reporting and/or expand reporting requirements, if it considers this necessary to carry out its supervisory responsibilities.

37. **Insurance companies are governed, as they were during the previous ROSC analysis, by UNMIK Regulation No. 2001/25 (the Law on Insurance) and the CBK's strict regulations. The Law on Insurance requires that insurance companies maintain their books and prepare financial statements "in accordance with International Accounting Standards."** However, Rule 7, dated October 18, 2001, amending the Law on Insurance requires that insurance companies set up technical provisions and that, "technical provisions notably include a provision for unearned premiums and a provision for unpaid claims and claims incurred but not reported…. CBK will establish a permanent ratio of incurred losses and a permanent percentage for incurred but not reported losses. The financial statements will record these established amounts or the actual amounts, whichever is greater."[26] Rule 7 therefore instructs insurance companies to depart from IFRS.

38. **The appointment of the auditor is subject to CBK approval, and the Law on Insurance imposes the "whistle-blowing duty" on an auditor who detects instances of fraud and systematic transgression of CBK rules.** Also, each insurance company and insurance intermediary is obliged to prepare quarterly reports for the CBK concerning its administration and insurance operations, liquidity, solvency, and profitability. These reports cover the parent company and its subsidiaries, on an individual and a consolidated basis. Insurance companies also submit each month a balance sheet, income statement, investment report, premium register and claims register using a format prescribed by the CBK.

39. **There are plans to liberalize the insurance sector in the near future. Presently, none of the insurance companies publishes a full set of financial statements on their websites. Only fragments, e.g., the balance sheet and auditors' report are readily available to the public.** The CBK does not require that insurance organizations publish their audited financial statements; therefore, the publishing requirement of the Law on Business organizations prevails in this sector.

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[26] Rule 7 on Amending Rule on Accounting Standards and Record-keeping Requirements for Insurance Companies and Insurance Intermediaries dated as October 18, 2001

40. **The new Law on Banks was adopted in April, 2012.** The law provides guidance transforming MFIs into commercial banks. Two major issues involved in such a transformation include capitalization and retroactive taxation. Typically, an NGO was established by a donor-financed grant, i.e., there is no capital, and the founder is usually another, mostly foreign NGO(s). Any MFI wishing to transform itself into a bank must first be transformed into a joint-stock company under the law on business organizations. CBK notes that it is necessary to establish the address of the future bank and, also, to deposit capital into the entity being transformed. Many MFIs have been successful in their activities and their accumulated surpluses have so far been exempt from taxation under their status as an "institute of public benefit." There is now a provision in the new law on banks that, on transformation, when the "public benefit" status expires, both the donated capital and accumulated surplus may be subject to retroactive taxation by the Tax Administration.

II.B The Accounting and Auditing Profession

41. **The accounting and auditing profession in Kosovo has developed rapidly as a result of significant technical assistance combined with effective leadership and governance arrangements.** UNMIK Regulation 2001/30 (UNMIK Law) was replaced by Law No.04/L–014 on Accounting, Financial Reporting and Audit (Law on Financial Reporting) in 2010. However, the framework created by the UNMIK Law has been left largely intact. The new framework reaffirmed the existence of a "super-regulator," even though its title was changed from the Kosovo Board on Standards for Financial Reporting (KBSFR) to the Kosovo Financial Reporting Council (KFRC).

42. **The law does not formally recognize SCAAK as the sole professional association for accountants and auditors.** However, the conditions the law sets out for the certification (by the KFRC) of any future association are so strict that it will be difficult for any competition to SCAAK to emerge any time soon. Any new association must demonstrate to the KFRC that it has met all the requirements of the law and complied with all standards, guides and recommendations promulgated by IFAC.

43. **The Financial Reporting Law requires licensed auditors to be members of a recognized accounting association.** In theory, this might result in a scenario where several professional associations include auditors. However, given the small size and context of Kosovo, one strong professional body should be developed at this time. **Indeed, in the light of the proven competence of some SCAAK members, some form of temporary capacity-building assistance from SCAAK to the KFRC should be considered in order to enhance the capacity of the KFRC.**

44. **The KBSFR had recognized SCAAK as Kosovo's professional accountancy (including auditing) body, and it is assumed that SCAAK's recognition continues under the Law on Financial Reporting.** Having been the beneficiary of significant donor support, SCAAK has developed a good certification program for accountants and auditors. The current program is benchmarked to the standards of the International Accountancy Education Standards Board (IAESB) and the requirements of the EU Statutory Audit Directive; it has a

three-stage structure that is similar to that of the Association of Certified Chartered Accountants' (ACCA) qualification program.

45. **With a membership of about 700, SCAAK is able to generate sufficient revenues and is now self-sustaining.** Revenues are derived primarily from professional education (both pre- and post-qualification) activities, which amount to about 80% of its total receipts. SCAAK has not been successful in convincing its members to pay annual membership fees. These are only paid by auditors, who must be members in good standing of a professional association, and by students, who would not be allowed to sit for exams if they had outstanding arrears. Other members pay their fees only sporadically; but, for tactical reasons, SCAAK has chosen not to take a disciplinary action against delinquent members. As noted in the 2006 ROSC Report, "the lack of a tradition of external auditing in Kosovo and the legacy of a culture of control have contributed to a general lack of awareness in the business and wider community of the potential benefits of the audit, and the potential importance of the role of a well qualified accountant in the economic development of Kosovo." This statement remains valid; even though some there have been some improvements. Accounting is still seen by many as a regulatory burden, not as a source of information for decision-making and planning purposes. **Both the KFRC and SCAAK should continue working to build awareness of the benefits of accounting and auditing, building on the series of consultations with businesses on the changes in legislation and on the importance of compliance and transparency that were organized in the first half of 2012.**

46. **SCAAK successfully met the membership requirements and was admitted as a full member of IFAC in 2009.** There were three major recommendations concerning SCAAK in the 2006 ROSC Report. These included the following:

- Provide Continuing Professional Development (CPD) and training;
- Regulate and monitor its members engaged in public practice; and
- Establish procedures for disciplining its members.

SCAAK currently operates a CPD program, and it has been developing (with the Dutch professional association, NIVRA) procedures for regulating and monitoring the performance of its members engaged in public practice. **However, there is a need to act in coordination with the KFRC on disciplinary procedures, and no such coordinated action has yet taken place.**

II.C Accounting Education and Training

47. **The curriculum at the Faculty of Economics of the University of Pristina (UOP) has been modernized; however, no integration of professional education has taken place, as the universities and SCAAK have not agreed on terms**. In 2008, five students from UOP were sent under a USAID-funded program to study for twelve months in the Master of Accounting program at the Arizona State University. The conditions of the funding included a commitment by UOP to retain those individuals on their return to Kosovo as members of the Accounting Department. Upon their return to Kosovo in 2009, these individuals developed a three-year accounting program. However, four of the five individuals have since left UOP. The program was rolled out but discussions to integrate the UOP program and SCAAK's

certification program have not yet led to tangible results.

48. **It is not clear to what extent the UOP accounting program follows the curriculum created in 2009, and UOP's accounting graduates have not been granted exemptions from SCAAK's certification program.** Limited resources and students' effort would be more effectively utilized if these programs were integrated; however, integration should not require that SCAAK compromise its rigorous rules and procedures. **All stakeholders should recognize that a failure to bridge the differences between the profession (represented by SCAAK) and UOP damages the prospects for raising the standard of accounting education in Kosovo.**

49. **The KFRC is responsible for the quality of professional education.** The Law on Financial Reporting stipulates that, in order to become an auditor, the individual must be a member of a recognized professional association. Further, the Law requires that professional associations may certify only those individuals who completed a certification program that complies with International Accounting Education Standards (IES).[27] The KFRC is responsible for certifying accounting associations, one of the criteria being the quality of the candidate association's certification program; thus the KFRC has a decisive input regarding the quality of professional education. There have previously been efforts by individuals or groups of individuals to meet the requirement to develop a quality certification program by submitting to the KBSFR unauthorized copies of SCAAK materials; the KBSFR rejected all these applications.

50. **SCAAK has established a program to certify accounting and auditing professionals that complies with the Law on Financial Reporting. The program was upgraded significantly after 2006 to address the restrictions placed on entry into the profession by that law. The current SCAAK certification program meets the requirements of the Statutory Audit Directive and International Education Standards (IESs).** The SCAAK curriculum for accounting technicians, certified accountants and auditors was initially established in 2001, and has attracted nearly 4000 applicants since then. This is *prima facie* evidence of a strong demand for professional training. That program, which relies on translated and regularly updated ACCA training materials, consists of the following three stages:

Qualification and number	Entry Requirement	Exam Requirement	Experience Requirement
Accounting Technician As of December 2011 - 368 (135 active)	Same as for admission to University program	• Financial accounting 1 • Cost accounting • Management information systems • Commercial law and taxes	One year of accounting experience
Certified Accountant As of December 2011, 221 (119 active)	A University degree in economics or business and completed accounting technician examinations	• Financial reporting • Audit • Financial Management • Advanced Management Accounting	Proof of at least three years of accounting experience

[27] IESs are issued by IFAC's International Accounting Education Standards Board (IAESB).

Auditor As of December 2011, 139 (96 active, including 11 grandfathered)	Completed certified accountant stage	• Advanced Financial Reporting • Advanced Audit and Assurance • Strategic Management • Professional Practice	Proof of at least three years of experience working with auditor

51. **The restriction in the new Law on Financial Reporting limits entry to the profession (as a Certified Accountant) to accounting, business, or economics graduates. Unless adapted, this restriction will have devastating implications for students currently enrolled in the certification program who do not meet this criterion.** In October, 2012, the KFRC introduced a transitional arrangement, to enable aspiring professionals who hold university degrees, in other fields, and who enrolled the SCAAK certification program prior to the approval of the new Law, to complete the program and enter the profession.

52. **SCAAK's entry requirements for its program of professional education for accountants and auditors are in compliance with IES 1, *Entry requirements to a program of professional education*, and the content of the professional accounting education program complies with IES 2, *Content of Professional Education Programs*.** The program, which is based on a renowned international educator's textbooks, is now aligned with IFRS and ISA; the lack of such alignment was noted in the 2006 ROSC Report and evaluated as "a major weakness."

53. **SCAAK has implemented a system of pre-approval, monitoring and effective control of the quality of experience obtained by accountants and auditors, as required by IES 5, *Practical Experience Requirements*.** However, the system is focused on assessing formal compliance with established criteria (e.g., required number of hours spent on auditing, tax and accounting); the qualitative aspect is still missing from the assessment of practical experience.

54. **SCAAK's examination policies were modeled on the Examination Administration Advisory document provided by IFAC, and meet the requirements of IES 6, *Assessment of Professional Capabilities and Competence*.** Early in its existence, SCAAK implemented measures to provide anonymity for candidates and to protect the integrity of the examination process. It was more difficult to ensure that persons engaged in providing the courses were not involved in the formulating or administration of examinations; this resulted from SCAAK's very limited capacity at its outset. As the pool of tutors and examiners has grown, SCAAK's procedures for maintaining the anonymity of candidates and the independence of examiners have become more rigorous.

55. **Accountants and auditors are required to take part in programs of continuing professional development (CPD).** IES 7, *Continuing Professional Development* regulates the CPD requirement for all accountants and auditors. Since 2008, SCAAK has required that all certified accountants (and, thus, also auditors) participate in 40 hours of CPD every year; certified accountants must have least 18 hours of formal, verifiable CPD annually, and licensed auditors need 24 hours of formal, verifiable CPD. The members are required to assess which CPD content is relevant to them, based on their work and/or specialization.

56. **SCAAK has made progress in working towards compliance with the Statements of Membership Obligations (SMO) issued by IFAC.** Given that SCAAK has no role in standard setting, SMO 3, 5 and 7 (ISA, IPSAS and IFRS implementation) are not really applicable, even though on an informal basis SCAAK's expertise is regularly sought by the KFRC (and previously by the KBSFR). SCAAK has complied with SMO 2 and 4 (IES and 2010 Code of Ethics). SCAAK needs to improve compliance with SMO 1 and 6 ("Quality Assurance" and "Investigation and Discipline"). A Quality Assurance system has been developed with the help of the Dutch professional association, NIVRA; however, no tangible results were available at the time of this report's completion. As noted above, the issue of investigation and discipline needs to be addressed in coordination with the KFRC, which holds the required legislative authority. Until now, SCAAK has not performed an investigation and discipline procedure, and improvement in this area is needed as a matter of urgency.

II.D Accounting and Auditing Standard-setting

57. **The Law on Financial Reporting requires that the KFRC issue accounting standards that comply with IFRS. As was the case in 2006 with the KBSFR, the current structure and resources of the KFRC are inadequate to enable it to fully discharge this mandate**. The KFRC is the standard setter and regulator for non-financial sectors. The wording of the Law on Financial Reporting does not mention Kosovo Accounting Standards (KAS) in Article 5 (applicable accounting standards), although Article 14 makes KFRC responsible for the development of KAS. In March 2012, the KFRC issued an administrative instruction clarifying that KAS are applicable for 2012 to all companies; IFRS should be applied in future periods, starting January 1, 2013. Given the complexity of IFRS, a significant uncertainty exists in the accounting community as to whether this requirement is realistic. The KFRC has been working with the MEF to resolve the issue.

58. **The accounting profession is regulated, and the 2006 A&A ROSC Report concluded that, "… the KBSFR has not yet developed the capacity to carry out its mandate." The current ROSC has concluded that, despite the technical assistance provided to KBSFR after 2006, not much has changed in this area; indeed, in some ways, the KFRC is starting anew.** Like the UNMIK Law, the Law on Financial Reporting provides for funding of the KFRC through the Kosovo consolidated budget, and, as noted in the previous ROSC Report, the level of funding is insufficient for KFRC to discharge its responsibilities. KFRC's responsibilities include: (i) drafting and approving Kosovo Accounting Standards (KAS), in accordance with IAS/IFRS and relevant EU directives (however, **KAS are not mentioned in the section on accounting standards applicable in Kosovo**); (ii) supervising and implementing auditing standards, in accordance with ISA and relevant EU directives; (iii) licensing and maintaining the register of auditors as well as of the audit firms, as well as professional associations of accountants and auditors; (iv) stipulating the standards of professional ethics and internal quality to be followed by auditing firms; (v) supervising continuing professional education, quality assurance and disciplinary system for the profession.

59. **The KFRC consists of seven members. The Chairman and other members of KFRC are appointed by the Government for three year terms (one consecutive reappointment is allowed) based on nominees advanced by the following institutions: the CBK (1), academia (1), the MEF (1), the profession (1), and the business community (3).** In addition to the responsibilities listed above, the Law on Financial Reporting mandates that the KFRC collect and publish the financial statements of those business organizations that are required to make public their financial statements. Currently, KFRC has neither the human nor the technical capacity to discharge this additional responsibility; therefore, it is not clear how this function will be accomplished. Given that the fees and sanctions collected by KFRC are income of the budget, there is a **need to reconsider the KFRC "business model;"** it is not likely that KFRC can discharge all of its responsibilities within its existing structure. **Given the size of the Kosovo economy, it is estimated that five well-qualified and experienced professionals are needed to make KFRC fully functional.**

60. **As noted above, the KFRC urgently needs to consider whether its "business model" is appropriate for the discharge of its responsibilities.** Even though four professional committees have been appointed in 2011, it is not likely that the committees will be able to perform all standard setting and regulatory tasks without further significant support, and the support of at least four or five qualified, experienced, in-house experts, i.e., experts employed by the KFRC. At the same time, the KFRC should greatly benefit from the progress of Albania, where IFRS are translated and updated on an annual basis.[28] Albania has also arranged translations of ISA (2010 edition translated) and the IFAC Code of Ethics (the 2006 edition, which has since been superseded, is the only version that has been translated). While there are some differences in terminology, use of these Albanian translations is the optimal solution for Kosovo.

61. **The 2006 ROSC report concluded that "current staffing of KBSFR's secretariat is inadequate to allow KBSFR to regulate accounting and auditing effectively." This report comes to the same conclusion. KFRC's office (secretariat) employees do not have the accounting or auditing experience required to provide technical support to the committees and the KFRC.** In addition, unless there is a fundamental change in the way that the KFRC operates, this issue is unlikely to be addressed in the short- to medium-term; KFRC's inability to hire (and retain) qualified personnel as a consequence of the applicable government salary scale, which is well below market rates, severely constrains its ability to develop the needed capacity. For the KFRC to discharge fully its responsibilities, alternative sources of financing are necessary – the full range of tasks devolved to the KFRC cannot be funded solely from the budget. **Similarly to the experience of the Kosovo Auditor's General Office, the KFRC would greatly benefit from a twinning program or an equivalent arrangement to "import" institutional capacity and to mitigate the risk of regulatory capture.**

62. **The CBK sets accounting requirements for banks and insurance undertakings. The resultant systems meet the CBK's prudential objectives, but they are not fully consistent with "full IFRS."** Although differences exist (loan provisioning and technical reserves)

[28] http://www.kkk.gov.al/faqe.php?id=1&l2=101

between CBK financial reporting rules and IFRS, the differences do not represent a major difficulty even in cases where the amounts are material. The CBK discussed with the ROSC team the possibility of a footnote reconciliation disclosure, which would eliminate the current practice of having to prepare two almost identical sets of financial statements and two auditors' reports; the relevant regulation was subsequently drafted and views of the ROSC team were sought.

II.E Enforcing Accounting and Auditing Standards

63. **Unlike the UNMIK Regulation, the Law on Financial Reporting contains sanctions for non-compliance**. **However, the KFRC currently lacks the capacity to enforce the law; and, unless the necessary capacity is developed, this situation is not likely to change in the foreseeable future.** This capacity issue is exacerbated by the provision in the Law requiring the transfer of all funds collected by KFRC to the state consolidated budget. As noted in the 2006 ROSC report and also previously in this report, a fundamental increase in KFRC's institutional capacity is necessary for KFRC to fulfill all the requirements of the Law. For the immediate future, a greater involvement of the profession may serve as an interim solution, given SCAAK's rapid development.

64. **The CBK monitors and enforces compliance with IFRS, as applied in Kosovo, in the financial statements issued by banks, insurance companies MFIs and those Non-Bank Financial Institutions (NBFIs) that apply IFRS.** Even though prudential regulation and supervision receives more attention than enforcement of accounting standards in the preparation of general purpose financial statements, the CBK does employ inspectors to review compliance with financial reporting requirements.

65. **Although it relies on auditors to flag issues of compliance with IFRS in general purpose financial statements, the CBK has developed some capacity of its own to enforce IFRS.** Since the 2006 ROSC, the CBK's capacity to review the statutory financial statements presented by banks and insurance undertakings has increased; in addition, the risk related to non-compliance is offset by the banks' lack of involvement in complex financial transactions. Still, as in the past, CBK relies on audit firms with international affiliations to verify that banks and insurance companies are complying with IFRS. One comment from the 2006 ROSC regarding the reliance of CBK on auditors is still valid:
"It is not supported by an adequate system of external quality assurance subject to public oversight. Consequently, audit firms are essentially not monitored and there is little assurance regarding the quality of their audits other than the reliance on their reputation."

III. Observed Reporting and Auditing Practices

III.A Status of IFRS Adoption in Kosovo

66. **Two sets of accounting standards have been in effect in Kosovo since 2001: (i) the Kosovo Accounting Standards (a selection of modified "2001 IAS"), or "KAS," and (ii) IFRS. KAS have never been updated. The review of KAS was conducted in 2006 as part of the first A&A ROSC. As was to be expected, it identified significant differences between KAS and IFRS already at that time.** Some of the differences, still valid, between KAS and IFRS included:

- *Impairment of assets may or may not be recognized under KAS.*
- *Liabilities for employment benefits may be understated.*
- *There is no KAS equivalent of* IAS 41, *Agriculture.*
- *KAS do not deal with consolidated financial statements.*
- *KAS have not been updated for other new and revised IFRS, including revisions to IAS, issued by the IASB since 2001.*

The KFRC decided to require KAS in 2012 and intends to introduce the IFRS for SMEs in 2013.

67. **The Law on Financial Reporting requires the KFRC to issue auditing standards that conform to ISA.** As noted above (para. 60), the KFRC should benefit from the Albanian translation of ISA, given that it presently does not have the capacity to introduce its own auditing standards. Further, the use of the Albanian translation is also recommended on account of IFAC's policy to support, where possible, only one translation of its standards in any given language. In September 2012, a memorandum for the use of the Albanian translation of ISA in Kosovo was signed with the Albanian translating body IEKA. [29]

68. **As in 2006, no mechanism currently exists for monitoring and enforcing auditing standards and other requirements related to the audits of banks. This is further exacerbated by the lack of clarity over who has that enforcement authority.** The CBK does not have any enforcement powers in relation to quality assurance (except for approving the banks' auditors); and, no other agency has such powers, given that the Law on Financial Reporting excludes the CBK from enforcing audit standards and the KFCR from regulatory activities in the banking sector. SCAAK has established a quality review scheme for auditors; however, the development of the system is a mid- to long-term effort.

69. **Audit quality among entities subject to some form of regulation, e.g., by the CBK or by a foreign parent, has improved substantially.** However, the issues resulting from the lack of understanding and proper usage of ISA persist, though to a lesser extent than in 2006. The 2006 report noted that, *"… problems with the objective of an audit, audit risk*

[29] http://www.ifac.org/about-ifac/translations-permissions/translations-database

assessment, basic audit procedures, and other such common problems" existed. While SCAAK has made significant progress in introducing and enforcing the CPD requirement, inadequate understanding of audit principles, and the objective, performance and documentation of an audit still prevails among many sole practitioners and in many small practices.

III.B Review of Financial Statements

70. **This ROSC reviewed a sample of 22 sets of audited financial statements:**

- Fifteen sets were prepared in accordance with IFRS, and seven sets were prepared in accordance with Kosovo Accounting Standards (KAS);
- Seven sets of audited financial statements were from the financial sector, including three banks (two domestic and one foreign), three insurance companies (two foreign, one domestic) and one micro finance institution. All of these financial statements were prepared in accordance with IFRS;
- Two sets of audited financial statements were from publicly-owned enterprises, prepared in accordance with IFRS;
- 13 sets of financial statements were from other corporations; six of which were prepared in accordance with IFRS, and seven in accordance with KAS.
- Financial statements subject to the review were audited by both member firms of large international networks (Big Four) and by member firms of second-tier international networks. Of 22 audit opinions, ten were clean, two clean with an emphasis of matter, six were qualified, one was qualified with an emphasis of matter, one was qualified with another matter, and two were with disclaimers.

71. **Overall, compared with the 2006 ROSC, the quality of financial reporting as well as audits, particularly in the financial sector, <u>has improved</u>**. The reviewers did not identify material departures from applicable standards in the financial statements subject to the review, though many deficiencies were noted. Caution is required, however, before drawing broad conclusions from the results of this review. Virtually all of the financial statements reviewed are subject to some form of regulation or enforcement, whether by the CBK or by a foreign parent; as a result, these companies are likely to be financially stronger with better accounting than the norm. The list of comments made by the reviewers is attached in Annex 1.

III.C Perceptions of the Quality of Financial Reporting

72. The 2006 ROSC Report concluded that, "**Corporate financial reporting in Kosovo is perceived to be of very low quality, with the exception of the audited financial statements of financial institutions, which are perceived to be of relatively higher quality." To obtain an update, the ROSC team organized a workshop in Pristina on April 16, 2012.** The workshop was attended by almost 40 professional accountants and auditors, SCAAK members. The participants represented primarily professional accountants in business, about a third of them were licensed auditors. The following is the summary of their views.

73. **The low quality of financial reporting persists within the largest segment of Kosovo businesses – micro-entities – and, to a lesser degree, in small- and medium-size enterprises.** Financial reporting among financial institutions and entities audited by local member firms of international networks is perceived to have improved significantly.

74. **There is a perception, particularly among professional accountants, that regulatory capacity in relation to accounting and auditing is not what it should be, despite some improvement over the last two years.** Some believe that accounting should be regulated similarly to auditing to ensure quality improvement. There appears to be a perception that financial reporting has generally improved over the last five years. Many accountants believe that the presence of the statutory audit requirement, as well as the increased engagement of SCAAK, have driven the improvements.

75. **The issue of requiring different sets of financial statements for various users has, to some extent, subsided and is no longer considered a pervasive problem.** Although there has been an increase in the use of financial statements by financial institutions, banks still lend to businesses mainly on the strength of posted collateral. Since a vast majority of companies are owner-managed, owners are not typically users of the financial statements. At the same time, there is a perception that management's perception of the usefulness of financial statements and audit has increased since 2006. However, there is still a need for significant training on the application of both IFRS and ISA.

76. **Disclosures are generally perceived as inadequate in that they usually include only a breakdown of balances in the financial statements, without a discussion of policies or additional information that is relevant for users and is required by reporting standards.** There is also a perception that the recently issued administrative instruction by the KFRC for all companies to use KAS in 2012 and IFRS thereafter is not realistic; application of IFRS will result in significant additional cost to smaller entities. To resolve this, the KFRC has indicated that it was working with the Ministry of Economy and Finance to amend the law and introduce the IFRS for SMEs in 2013.

77. **In relation to accounting education, there is some sense of improvement at the university level since the 2006 ROSC but it is not enough.** Many accountants feel that tertiary education is, in general, still attached to the "old way" of doing things and that coordination of efforts between various players (i.e., middle schools, SCAAK, universities) is insufficient.

78. **The requirement for an annual renewal of audit licenses by the KFRC and the CBK (for auditors of financial institutions) imposes an unnecessary regulatory burden and should be reconsidered**. The renewal procedure is not automatic even in instances where the license should be renewed if certain criteria are met (e.g., CPD hours, professional fees, no disciplinary action, etc.). Instead, both audit firms and auditors must submit a number of documents annually to the KFRC and the CBK; in the case of auditors of financial institutions, the process is duplicative as a result of additional requirements set by the CBK. This process is not likely to foster higher audit quality.

IV. Recommendations

79. **The recommendations of this ROSC Update include the recommendations of the 2006 ROSC that have not yet been adequately addressed, most of which have already been discussed in this report. This report also includes additional recommendations from the analysis carried out in connection with this ROSC.** Generally, the recommendations fall under the six major pillars of the accounting and auditing infrastructure. In many instances, the reforms in each pillar need to be conducted in parallel, as the six pillars reinforce each other. For example, strengthening the standard-setting process without similarly bolstering the monitoring and enforcement mechanism will fail to address non-compliance with accounting standards. Critical success factors for implementation include leadership from the highest levels of government, capitalizing on current desire for change and balancing the incentives and disincentives for compliance with financial reporting requirements.

80. **The ROSC team has prepared detailed "concordance tables" that provide insight as to the current status of the alignment of Kosovo legislation with the EU's Accounting and Statutory Audit Directives.** The tables show that many improvements are required. Examples of areas where alignment has not been achieved include the following:

- Enforcement of the requirement to publish financial statements;
- Definition, monitoring and enforcement of professional pre-qualification experience for statutory auditors;
- Definition of the role of professional associations in the financial reporting system – the Law on Financial Reporting envisages the possibility of more than one accounting association; however, should any such new association comprise both accountants and auditors (like SCAAK), this would likely lead to regulatory inefficiencies and lapses in Kosovo's unsettled regulatory environment;
- Establishment of a public register of statutory auditors and audit firms, containing all the information required by the EU's Statutory Audit Directive;
- Establishment of a functioning public oversight system for the audit profession. In this context, a working balance between the roles of SCAAK and the KFRC should be sought and achieved. A viable option remains, <u>on a temporary basis</u>, giving SCAAK a role in quality assurance review, subject to public oversight by KFRC;
- Implementation of the quality assurance program currently being developed with the assistance of NIVRA; and
- Review of the current criteria concerning the obligation to have a statutory audit.

81. **The legal requirement to publish financial statements should be implemented.** This requirement has existed since 2001 but never has been implemented. No financial statements, with the exceptions of financial institutions and some POEs, are publicly available. This needs to be addressed. In particular, a formal legal requirement that is not implemented does not constitute alignment with the European legislation and this will certainly be noted by any future European Commission review.

82. **With regard to accounting standards, building on the progress achieved since 2006, KFRC should:**

- ***Establish or adopt accounting standards applicable to SMEs and micro-enterprises***; under the existing interpretation of the law, these entities are expected to apply full IFRS from 2013 – this is not reasonable and will not succeed. KAS or the IFRS for SMEs should be considered for SMEs, with income tax reporting (e.g., summary of receipts and disbursements) for micro-entities;
- ***Monitor the application of IFRS,*** in both the financial and non-financial sectors, for financial institutions, this should be carried out in close cooperation with the CBK;
- ***Consider entering into a cooperative arrangement with the Albanian Accounting Council***, including consultations on enforcement;

83. **The KFRC should deepen its cooperation with the Institute of Authorized Chartered Auditors of Albania (IEKA)**, on translation and adoption of ISA, including consultations on enforcement;

84. **With regard to the Monitoring and Enforcement of Accounting and Auditing Standards, it is recommended that:**

- The KFRC and the CBK increase their capacity by employing more staff members who are familiar with IFRS. In order to fulfill their role as agencies regulating accounting standards, the KFRC and the CBK should recruit additional staff with extensive knowledge and experience of IFRS. The KFRC's embedding within the public sector should be reconsidered, since it may limit the KFRC's ability to increase its professional capacity. Consideration should be given to making the KFRC a self-financing regulatory agency;
- As in 2006, it is recommended that all statutory auditors and audit firms should be subject to a system of quality assurance, subject to public oversight. The KFRC is formally responsible for quality assurance but it has neither the human nor the professional capacity to perform this task. At present, the only available capacity exists within the profession, i.e., SCAAK. The oversight model should consider which mechanism would function best in Kosovo's current circumstances. For example, the model of supervised self-regulation, where the investigation function is performed by SCAAK, but the evaluation of the findings and sanctions could be made by KFCR might be considered. Such system may not be immediately fully aligned with the *acquis,* particularly with the Commission's Recommendation of 6 May 2008, (2008/362/EC) on external quality assurance for statutory auditors and audit firms selected to audit public interest entities. However, including professionals would help the KFCR to start with a program of inspections and the involvement of the KFCR could then increase over time, as its own professional capacity develops. Another possibility is to use Albanian inspectors in Kosovo, although even this option would face the financing question. In any case, as the 10-year history of the KBSFR demonstrated, the status quo does not work and the configuration needs a change to make it work. The KFRC has taken first steps in this context, including setting up the Quality Assurance Committee and initiating cooperation with its Croatian counterpart.

It is expected that the first Quality Assurance cycle will start in 2015.

- The CBK and the KFRC should revisit their audit license renewal policies with the objective of easing the existing regulatory burden and using criteria such as CPD compliance, quality review results, etc. instead.

85. **With regard to the Development of the Accounting and Auditing Profession, it is recommended that:**

- The KFCR upgrade the register of auditors and audit firms (currently, the register is an Excel spreadsheet with no indication as to the frequency of updates) to align it with the requirements of the Statutory Audit Directive;
- SCAAK increase its capacity in relation to quality assurance; as indicated above, this should be done in coordination with the KFCR;
- Practical experience requirement be brought into line with IFAC requirements; the present requirements for practical experience have been reviewed and changes are being implemented to bring the practical experience requirement in line with IES 5. [30]

86. **With regard to Education and Training, it is recommended that:**

- SCAAK and the University sector re-engage on the issue of enhancing access to and the contents of quality accounting education at universities. It is wasteful for all stakeholders if university accounting graduates receive no exemptions in the SCAAK certification program. At the same time, SCAAK needs to obtain assurances that the university program provides an appropriate foundation for future professional accountants.
- SCAAK further enhance its CPD program. There are still many observed deficiencies in the work of sole practitioners and small practices. The focus of enhanced CPD should be on those areas where the deficiencies have been observed, for example:
  - ISA and IFRS;
  - Audit documentation and audit file;
  - Obtaining sufficient appropriate audit evidence;
  - Audit risk assessment and its impact on audit strategy and planning;
  - Forming an audit opinion and communication with the client, etc.

[30] http://www.ifac.org/sites/default/files/publications/files/ies-5-practical-experienc.pdf

Annex 1. Summary of the Review of Financial Statements

ISA

Qualified opinion

- In general, audit reports were qualified because the auditors were unable to obtain sufficient appropriate audit evidence. In some instances, however, the basis for the qualification did not appear to be appropriately disclosed and supported.

Emphasis of matter

- Emphasis of matter paragraphs were the result of uncertainty involving valuation, ownership, future liability and contingent tax liability.

IFRS

Intangible assets

- Two identified instances of departure from the standard involved classification and research and development costs treatment.

Functional and presentation currency

- Functional and presentation currency was not disclosed **(**IAS 21.8., "*The Effects of Changes in Foreign Exchange Rates")*

Credit risk

- Incomplete disclosure in two sets of financial statements (trade receivables and impaired loans)

Going concern

- In seven instances, the required management disclosure on going concern was missing.

Borrowings

- One case of unclear measurement method of the relevant interest rate.

Segment reporting

- Incomplete disclosures identified relating to revenue streams and segment assets and liabilities.

Interest

- Inadequate disclosures, in two instances, of effective interest rate and interest revenue recognition.

Impairment

- Inadequate disclosures, in two instances, of the asset impairment policy and discounting of impaired loans policy.

Leases

- Incomplete disclosures of operating lease, operating lease income, other lease-related information.

Adoption of new and revised International Financial Reporting Standards

- Incomplete disclosure of the likely effects of IFRS9 '*Financial Instruments'* on classification and measurement.

Presentation

- Incomplete disclosure of financial instruments, specifically IAS 32.42., IAS 2.36.

Related parties

- Three instances of incomplete related party disclosures identified

Risk management

- Incomplete disclosure in the Annual Report identified in one instance

Hedging

- One instance identified of derivatives used to hedge risks but without hedge accounting.

Statement of changes in equity

- Described in one instance as "Consolidated statement of cash flows for the period."

Borrowings

- One instance of incomplete disclosure in relation to covenants breached by the borrower (IFRS 7.18) – no disclosure of amounts involved

Deferred Taxes

- One instance of failing to present deferred tax

Liability Adequacy Tests (LAT) (IFRS 4.15.)

- Required disclosure not provided in one instance

Concentration of insurance risk

- Required disclosure not provided in one instance

NATIONAL STANDARDS (KAS)

Revenue

- One instance of incomplete disclosure, no policy on recognition and measurement.

Impairment

- One instance of no disclosure on impairment of assets, also no evidence if the entity has assessed whether any asset may be impaired.

Leases

- No leases disclosed in one instance. The entity rents the office and warehouse space.

Financial Instruments

- The company has disclosed cash, accounts receivable and payable but NO policy on presentation, recognition or measurement is disclosed.

Annex 2: Status of the Recommendation of the 2006 ROSC A&A

It is recommended that a multi-disciplinary group of private and public stakeholders be established.	Not established.
Prepare a "transposition table" showing for each relevant provision of the *acquis communautaire* how corresponding Kosovo legal instruments implement the provision.	Transposition (concordance) table not completed (Para 80).
Drawing on this analysis, the group should contribute to the proposed amendments to the Law on Financial Reporting in order to align it more closely with the [Audit] Directive.	The new law was prepared without the concordance table; numerous instances of non-alignment with *the acquis* remain (Para 80).
Restructure the institutional framework and achieve a working balance between the roles of SCAAK and the KBSFR.	**Partially completed** (SCAAK is developing a quality assurance review program, Paras 49-56).
A requirement for public interest entities to present their financial statements in conformity with IFRS.	**Completed**. IFRS will be required from 2013 (Para 57).
A requirement for enterprises that are not public interest entities other than micro enterprises to present their financial statements in conformity with KAS.	**Partially Completed**. According to the present law, the non-PIE companies will be required to apply IFRS, IFRS for SMEs are being considered (Para 57).
A requirement for legal entity and/or consolidated financial statements to be audited only when there is a public interest for such an audit, irrespective of the entity's legal form.	**Partially completed**; the new law narrowed the mandatory audit requirement (Para 27, 30).
A requirement for all statutory audits to be conducted in compliance with ISA.	**Completed** (Para 58).
A requirement for public interest entities (short term) and other corporations (longer term) to make their audited legal entity (and consolidated) financial statements, including the notes to the financial statements, readily available to the public within a reasonable period after the balance sheet date.	Not completed (Para 81).
Reach agreement with the International Accounting Standards Committee Foundation (IASCF) and the institutions responsible for the translation of the Albanian and Serbian language versions of the standards.	**No longer applicable** (both Albanian and Serbian translations exist in Albania and Serbia, para 84).
The KBSFR maintain KAS as a simplified financial reporting system for application in entities that do not meet the definition of a public interest entity. Alternatively, Kosovo could review the ongoing project	Not completed; the law does not consider KAS as accounting standards applicable in Kosovo, even though still requires the KFRC to maintain it. The

of the International Accounting Standards Board (IASB) on "Accounting Standards for SMEs."	IFRS for SMEs is not currently applicable in Kosovo (Para 84).
BPK [should] revisit the relationship between prudential and general purpose financial reporting in the financial sector. BPK should develop prudential filters for regulatory capital.	**Completed** (Para 62).
Reach agreement with IFAC and the institutions responsible for the translation of the Albanian and Serbian language versions of the standards (…).	**No longer applicable** as both Albanian and Serbian translations exist in Albania and Serbia (Para 82,83).
More direct action [should] be taken with regard to the monitoring and enforcement of accounting and reporting standards by public interest entities.	Not completed (Para 24, 25)
The KBSFR and BPK should increase their human resources by employing more staff members who are familiar with IFRS.	**Partially completed by the CBK** (Para 64).
The BPK should seek to strengthen its relationship with statutory auditors to mutual advantage. While the objectives of supervisors and auditors are different, there are many areas where the work of the supervisors and of the external auditor can be useful to each other.	**Partially completed** (Para 65).
(...) BPK may contemplate requiring the statutory auditor to carry out specific assignments or to issue special reports to assist the supervisors in discharging their supervisory functions (…).	Not completed; not considered a priority.
All statutory auditors and audit firms should be subject to a system of quality assurance subject to public oversight.	**Partially completed** – the law provides for oversight of auditors; however, it has not been implemented (Para 41, 46).
Kosovo should establish an effective system of investigations and sanctions to detect, correct and prevent inadequate execution of the statutory audit.	**Partially completed** – the law provides for oversight of auditors; however, it has not been implemented (Para 41, 46).
Also, every measure taken or sanction imposed on statutory auditors and audit firms should be appropriately disclosed to the public. As for the quality assurance system, the system may draw upon existing practices in EU Member States and IFAC SMO 6, Investigation and Discipline (…).	Not completed (Para 41, 46).
All statutory auditors and audit firms should be members of SCAAK.	**Partially completed** (Para 43; firm membership not required, only license by the KFRC).
SCAAK (or the KBSFR) should establish a public electronic register of statutory auditors and audit firms so that interested parties can determine rapidly whether a statutory auditor or an audit firm has been approved, etc. This will be facilitated through registration in a	**Partially completed**; the register exists and is public but is not regularly updated and does not contain the information required by the Audit Directive (Para 80).

public electronic register.	
The capacity of SCAAK should be increased so as to enable it to make a more effective contribution to the audit profession in Kosovo.	Partially completed; SCAAK offers some advice to its members; some guidance for small audit firms has been developed.
Practical experience should be brought in line with IFAC requirements. Mentorship and supervision have to be promoted. It is necessary to review the present requirements for practical experience and to bring them in line with IES 5.	**Partially completed**; mentorship and supervision have not been implemented (Para 53, 86).
Emphasis should be given to developing an educational continuum from university through to the continuing professional development of A&A professionals (…).	**Partially completed**; SCAAK program complies with IES but no integration with university education has taken place (Para 47, 48, 86).
The university curriculum and educational material should be updated.	**Partially completed**, although it is not clear to what extent the new materials are used (Para 47, 48).
Universities will need to work closely with the KBSFR, SCAAK, and the business community to develop degree programs appropriate to the developing needs of the economy.	Not completed (Para, 47, 48, 86).
SCAAK should also ensure that candidates for the audit qualification receive sufficient and relevant practical experience prior to the award of the qualification.	**Partially completed**; content of the practical experience requirement not established (Para 53, 86).
Having established a robust basis for qualification it is essential that continued membership of SCAAK and retaining the right to conduct audits (i.e., the license issued by the KBSFR) is dependent upon completing a minimum level of CPD. Such CPD needs to be monitored by SCAAK (…).	**Completed** (Para 55).

Annex 3: Concordance Tables (DRAFT)

Concordance Table 4th Directive.docx

Concordance Table 8th Directive.docx