

KOSOVO CREDIT GUARANTEE FUND

**Independent Auditors' Report and
Financial Statements for the year
ended December 31, 2016**

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Kosovo Credit Guarantee Fund

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Kosovo Credit Guarantee Fund (the "Fund" or "KCGF"), which comprise: the statement of financial position as at December 31, 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion the accompanying financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Fund in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 2.10 in the financial statements, which indicates that the Funds operations are not self-sufficient to cover all the expenditure incurred in operations. As stated in Note 2.10, these events or conditions, along with other matters as set forth in Note 2.10, indicate that a material uncertainty exists that may cast significant doubt on the Fund's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the Material Uncertainty Related to Going Concern section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Except for the matter described in Material Uncertainty Related to Going Concern section, we have determined that there are no other key audit matters to communicate in our report.



Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Fund's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.



- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

BDO KOSOVA L.L.C.

BDO Kosova L.L.C.
March 3, 2017
Pashko Vasa Str. No.46
10 000 Pristina, Kosovo

Kosovo Credit Guarantee Fund
Statement of Financial Position
As at December 31, 2016

	Notes	As at December 31, 2016 (EUR)
ASSETS		
Current assets		
Cash and cash equivalents	4	7,379,611
Receivables	5	<u>8,209</u>
TOTAL ASSETS		<u>7,387,820</u>
EQUITY AND LIABILITIES		
Current liabilities		
Accrual Guarantee Fees		35,609
Reserve for losses on Guarantees		<u>10,219</u>
Total current liabilities		<u>45,828</u>
EQUITY		
Capital	6	7,345,141
Accumulated loss		<u>(3,149)</u>
Total equity		<u>7,341,992</u>
TOTAL EQUITY AND LIABILITIES		<u>7,387,820</u>


Besnik Berisha
Managing Director




Vjosa Balaj
Senior Finance Manager

The accompanying notes on pages 8 to 18 form an integral part of these financial statements

Kosovo Credit Guarantee Fund
Statement of Comprehensive Income
For the year ended December 31, 2016

	Notes	Year ended 31 December 2016 (EUR)
Guarantee fees	7	7,070
Total income		<u>7,070</u>
Provision	8	10,219
Loss for the year		<u>(3,149)</u>
Other comprehensive income		
Total comprehensive loss for the year		<u><u>(3,149)</u></u>

The accompanying notes on pages 8 to 18 form an integral part of these financial statements.

Kosovo Credit Guarantee Fund
Statement of Changes in Funds balance
For the year ended December 31, 2016

	Capital (EUR)	Accumulated loss (EUR)	Total (EUR)
As at January 1, 2016	-	-	-
Paid in capital	7,345,141	-	7,345,141
Loss for the year	-	(3,149)	(3,149)
As at December 31, 2016	<u>7,345,141</u>	<u>(3,149)</u>	<u>7,341,992</u>

The accompanying notes on pages 8 to 18 form an integral part of these financial statements.

Kosovo Credit Guarantee Fund
Statement of Cash Flows
For the year ended December 31, 2016

	Notes	Year ended 31 December 2016 (EUR)
Cash flow from operating activities:		
Loss for the year		<u>(3,149)</u>
Movements in working capital:		
Decrease/(Increase) in receivables		(8,209)
Increase/(Decrease) in accruals		35,609
Increase/(Decrease) in reserves		<u>10,219</u>
Net cash generated by operating activities		<u>34,470</u>
Cash flow from financing activities:		
Paid in capital		<u>7,345,141</u>
Net cash used in financing activities		<u>7,345,141</u>
Net increase/(decrease) in cash and cash equivalents during the year		7,379,611
Cash and cash equivalents at the beginning of the year		<u>-</u>
Cash and cash equivalents at the end of the year	4	<u><u>7,379,611</u></u>

The accompanying notes on pages 8 to 18 form an integral part of these financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Current and deferred income taxes

According to LKCGF, the Fund is exempt from Corporate Income Tax, VAT, and tax on dividends, interest or investment income earned from funds on credit guarantees or investments, and any other levy, withholding or tax to any aspect of the operations of the Fund.

2.7 Revenue recognition

Revenue from services is recognized when all the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity;
- the stage of completion of the transaction at the statement of financial position date can be measured reliably; and
- the cost incurred for the transaction and the cost to complete the transaction can be measured reliably

The Fund's revenues are:

- (i) revenues from guarantee fees

Guarantee Fees

Once the loan is accepted and put under guarantee, the guarantee fee is also calculated. The guarantee fee is calculated based on the actual guarantee fee percentage specified for a Guarantee Agreement multiplied by the Approved Amount of the guarantee. The income from the guarantee fee is recognized on accrual basis for a period of 12 months. The guarantee fees are recognized as revenues in statement of comprehensive income at the end of each month by debiting Accrual Guarantee Fee and credit Guarantees Fees Income.

2.8 Provisions

Provisioning policy specifies the process of setting aside certain reserves for all credits that are placed under guarantees that are expected or have incurred credit loss. The provisioning policy is made in accordance with IFRS 9. The impairment of credit guarantees is done in three stages, based on changes in credit quality since initial recognition. The information provided by RFI regarding credit classification will be the key trigger for moving credit guarantee into stages and for measuring credit risk. Impairment in first stage is accounted for all credit guarantees irrespective of the credit quality, on the basis of expected loss over a period of 12 months. The credit guarantee will move to second stage (or from second to third) if there is a significant deterioration in the credit quality, if the contractual cash flows on the financial asset are not fully recoverable in the event of default. In both these stages, the impairment allowance is recognized based on the lifetime expected losses. The transfer of financial assets from one stage to another is symmetrical, which means that any financial asset can move back, if there is a significant improvement in the credit quality.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Commitments contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognized in the financial statements but disclosed when an inflow of economic benefits is probable. The amount of a contingent loss is recognized as a provision if it is probable that future events will confirm that, a liability incurred as at the statement of financial position date and a reasonable estimate of the amount of the resulting loss can be made.

2.10. Going concern

These financial statements have been prepared on a going concern basis which presumes the realization of assets and liabilities in the normal course of business. KCGF Operations until June 10, 2017 are fully subsidized by USAID Empower Credit Support Program, without eliminating possible future support from ECS June 10, 2017 is the date when KCGF is expected to be independent. USAID has committed to partially support KCGF's operating expenses after June 2017. The Fund's ability to continue as a going concern is dependent on its ability to obtain additional sources of financing its operations until it is self-sufficient. The outcome of these matters cannot be predicted at this time. The financial statements do not reflect adjustments to the carrying values and classification of assets and liabilities that might be necessary should the Fund be unable to continue as a going concern, and such adjustments, may be material.

3. FINANCIAL RISK MANAGEMENT

3.1 Introduction and overview

Risk is defined as effect of uncertainty events and their outcomes that may have a significant effect on KCGF operations. Risk management is the process of evaluating and responding to risks for the purpose of reducing those risks to acceptable levels. The evaluation of risk is based on identification of threats, as well as the likelihood of the threats being realized and the potential impact on the KCGF. Risk management uses the results of risk assessments to make decisions and to coordinate activities to direct and control an organization with regard to risk.

The KCGF Risk Management Policy sets out the key principles which in order to establish an appropriate system of risk oversight and management. The key principles for risk management are implemented in Guarantee Agreement, in existing policies and procedures as well as methodologies and tools for risk measuring, monitoring and reporting. Together these form the KCGF risk management framework.

3.2 Risk Governance Structure

The KCGF risk governance structure emphasizes oversight and control of risk and defines the processes and mechanisms by which decisions about risks are taken and implemented. KCGF's risk management governance structure begins with oversight by the Board of Directors. The Board receives regular updates on the key risks of KCGF - including a comprehensive summary of KCGF's risk profile and performance of the portfolio against defined goals, presented quarterly to the Board. The Board set forth risk appetites for credit risk and liquidity risk and approves key risk policies, limits, strategies. The Board also ensures that KCGF is taking appropriate measure to achieve prudent balance between risk and reward.

The Board of Directors has established two committees to supervise specific areas and to prepare topics for consideration by the Board: Risk Management Committee and Audit Committee.

Risk Management Committee - the committee reviews and submits recommendations to the Board of Directors regarding KCGF risk appetites, risk policies, risk instructions, capital, leverage, liquidity, products and services from a risk perspective, and loan portfolio credit quality.

Audit Committee -the committee operates as a preparatory committee for the Board of Directors with respect to accounting and auditing matters, including related risk matters.

In general, both committees assist the Board of Directors in ensuring strict risk management within KCGF and in ensuring that risk management and risk reporting are always compliant with law and the KCGF general principles.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Credit risk

Credit risk is the risk of loss resulting from the failure of a borrower to honor its financial or contractual obligations to a bank. KCGF's risks lies, correspondingly, with the banks. Should impaired loans at a particular bank increases, putting their portfolio at risk, this will in turn increase KCGF's, in the sense that KCGF may be called on the guarantees issued. This will have an impact on KCGF's capital position and expected fee incomes. Therefore, KCGF's counterparties' (RFI) credit assessment and their policies will influence the quality of KCGF's guaranteed portfolio.

For the purpose of Registering Financial Institutions, KCGF has implemented a Registration Policy which is aimed at ensuring registration of only financial institutions that are responsive and transparent and provide evidence of their ability to comply with KCGF requirements. The registration policy sets the key principles that financial institutions should have in order to be registered in KCGF:

- A sound capital base and financial position
- A good reputation in the market
- A willingness to further penetrate the MSME segment
- A willingness to reduce collateral requirements as a quid pro quo for KCGF's partial loan guarantees
- Sound loan underwriting policies and procedures

For ensuring the guarantee commitments that KCGF is taking within its risk bearing capacity and that its portfolio is well diversified, KCGF has adopted an Allocation Policy. This policy determines the risk appetite that KCGF is willing to take and sets the methodology for evaluating RFI exposure. The policy also sets the methodology for assessing RFI and allocating limits to RFI. The methodology defines that the main criteria for allocating an initial limit are market share and risk profile. However, exposure limits may be adjusted by the KCGF. Reasons for adjustment would include failure to use the allocated limit significantly or at all, poor quality of loans submitted for guarantee, or safety and soundness issues in the overall condition of the bank.

Provided that the registration process is completed, limit is allocated, and GA is signed, then an RFI is entitled to place credits under guarantee if they meet the pre-determined criteria specified in the guarantee agreement.

The KCGF began receiving loans for guarantee in late September 2016. At year end 2016, the portfolio was:

	Number of Loans Disbursed	Total Amount of Loans Disbursed (EUR)	Outstanding Amount of Loans (EUR)	Outstanding Guaranteed Amount (EUR)	Allocated Guarantee Amount Limit (EUR)
Total	86	4,353,500	3,874,629	1,854,406	27,500,000

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Liquidity risk

Effective liquidity risk governance is essential in order to maintain the confidence of donors and RFI, and to enable the core business to continue to generate revenue, even under adverse circumstances. Reliable arrangements, analysis of liquidity requirements, and contingency planning (for example, a stand-by line of credit, or counter guarantee arrangement) are crucial elements of strong liquidity.

KCGF acknowledges that capital that it is holding as liquid assets should provide support towards the achievement of its objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques that balance risk and reward, within the context of effective risk management.

For the purposes of optimizing potential returns within acceptable risk parameters, KCGF has prepared an investment policy that clearly sets out an investment framework consistent with KCGF mandate and its strategic objectives.

	31 December 2016			
	Up to 1 year (EUR)	1 to 2 years (EUR)	2 to 5 years (EUR)	Over 5 years (EUR)
Financial assets				
Cash and cash equivalents	7,379,611	-	-	-
Total financial asset	7,379,611	-	-	-
Financial liabilities				
Payables and other liabilities	45,828	-	-	-
Total financial liabilities	45,828	-	-	-

3.5 Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk can be created by a wide range of different external events ranging from power failures to floods or earthquakes. Similarly, operational risk can arise due to internal events such as the potential for failures or inadequacies in any of the KCGF's processes and systems, or those of its outsourced service providers. Operational risk arising from human resources management may refer to a range of issues such as mismanaged or poorly trained employees; the potential of employees for negligence, willful misconduct; conflict of interests; fraud; rogue trading; and so on. The KCGF's operational risk management focuses on proactive measures in order to ensure business continuity as well as the accuracy of information used internally and reported externally, a competent and well-informed staff, and its adherence to established rules and procedures as well as on security arrangements to protect the physical and ICT infrastructure of the KCGF.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

3.5 Operational Risk (continued)

KCGF's Operational Risk Management Framework:

- I) Clear strategies adopted by the Board of Directors and oversight exercised by Senior Management;
- II) Strong internal operational risk culture (Internal operational risk culture is taken to mean the combined set of individual and corporate values, attitudes, competencies and behavior that determine an institution's commitment to and style of operational risk management) and internal control culture, emphasizing on dual controls;
- III) High standards of ethics and integrity, and
- IV) Commitment to effective corporate governance, including, among others, segregation of duties, avoidance of conflicts of interest, and clear lines of management responsibility, accountability and reporting, as reflected in the KCGF's governance documents. All levels of staff shall understand their responsibilities with respect to operational risk management.

Insurance policies may be used to confront losses which may occur as a result of events such as third-party claims resulting from errors and omissions, employee or third-party fraud, and natural disasters.

3.6 Financial instruments presented at fair value

The financial assets measured according to the fair value in the statement of financial position in accordance with the hierarchy of the fair value are shown in the next table. This hierarchy groups the financial assets and liabilities into three levels that are based on the significance of the incoming data used during the measurement of the fair value of the financial assets. Fair value hierarchy is as follows:

- **Level 1:** quoted prices (not adjusted) on the active markets for identical assets or liabilities;
- **Level 2:** other incoming data, aside from the quoted prices, included in Level 1 which are available for asset or liability observing, directly (i.e. as prices), or indirectly (i.e. made of prices) and
- **Level 3:** incoming data on the asset or liability that are not based on data available for market observing

As of 31 December 2016, the Fund has no financial assets measured at fair value.

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

3.7 Financial instruments that are not presented at fair value

The following table summarizes the carrying amounts and fair values to those financial assets and liabilities that are not presented in the Statement of financial position at their fair value:

	Carrying value 2016 (EUR)	Fair value 2016 (EUR)
Financial assets		
Cash and cash equivalents	7,379,611	7,379,611
Total financial assets	<u>7,379,611</u>	<u>7,379,611</u>
Financial liabilities		
Payables and other liabilities	45,828	45,828
Total financial liabilities	<u>45,828</u>	<u>45,828</u>

4. CASH AND CASH EQUIVALENTS

	As at December 31 2016 (EUR)
Cash at Central Bank of Kosovo	7,379,611
Total cash and cash equivalents	<u>7,379,611</u>

5. ACCOUNTS RECEIVABLE

	As at December 31 2016 (EUR)
Receivable from clients	8,209
Total receivables	<u>8,209</u>

6. CAPITAL

Funds provided to the KCGF by the Government of the Republic of Kosovo and USAID as a grant.

As at 31 December 2016 Funds consist:

- Funds received from USAID in the amount of EUR 5,345,141.
- Funds received from Government of Republic of Kosovo (through Ministry of Trade and Industry) in the amount of EUR 2,000,000.

7. INCOME FROM GUARANTEE FEES

	Year ended December 31, 2016 (EUR)
Guarantee fees	7,070
Total receivables	7,070

Once the loan is accepted and put under guarantee, the guarantee fee is also calculated. The guarantee fee is calculated based on the actual guarantee fee percentage specified for a Guarantee Agreement (2%) multiplied by the Approved Amount of the guarantee. The income from the guarantee fee is recognized on accrual basis for a period of 12 months. The guarantee fees are recognized as revenues in statement of comprehensive income at the end of each month by debiting Accrual Guarantee Fee and credit Guarantees Fees Income.

8. PROVISION EXPENSES

	Year ended December 31, 2016 (EUR)
Provision expenses	10,219
Total expenses	10,219

Provisioning policy specifies the process of setting aside certain reserves for all credits that are placed under guarantees that are expected or have incurred credit loss. The provisioning policy is made in accordance with IFRS 9

9. CONTINGENCIES AND COMMITMENTS

	As at December 31, 2016 EUR	
	Number of Guarantees	Outstanding Guaranteed Amount (EUR)
Total	86	1,854,406

Other than the ones disclosed above there are no contingencies or commitments in existence as at the balance sheet date.

10. RELATED PARTY TRANSACTIONS

Related parties consist of the directors of the Fund. Parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

11. EVENTS AFTER THE REPORTING DATE

There are no significant subsequent events after the reporting date which requires adjustment or disclosure to these financial statements.