ANNUAL REPORT 2016

FONDI KOSOVAR PËR GARANCI KREDITORE
KOSOVSKI FOND ZA KREDITNO JEMSTVO
KOSOVO CREDIT GUARANTEE FUND


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GUARANTEE AGREEMENT No. KCGF-06-16

CONTENTS

EXECUTIVE SUMMARY
MANAGEMENT REPORT

The year 2016 marked the establishment and start of the work of the Kosovo Credit Guarantee Fund (FKGK), an institution which aims to provide guarantees for the loan portfolio of financial institutions, intended for micro, small and medium enterprises (MSMEs). This initiative was welcomed by all stakeholder's active in the economy of the Republic of Kosovo, as it is a step forward in supporting the country's private entrepreneurship, which is one of the most important pillars of Kosovo's economic development strategy.

Past experience from other countries in transition indicated that improving conditions for doing business, and facilitating access to finance for MSMEs were decisive factors in economic development, generating new jobs, and generally promoting ethical and democratic values in the society of the country.

Various studies conducted in recent years on the economic environment in Kosovo identified that Kosovo is like other transition countries in this, and one of the barriers hindering the development of MSMEs was access to finance, with a particular emphasis on the role of collateral in borrowing by MSMEs. A joint initiative three years ago by the Ministry of Trade and Industry within the government of the Republic of Kosovo, and USAID, therefore aimed at breaking down this barrier, and resulted in the establishment of the Kosovo Credit Guarantee Fund as a guarantee scheme for credit portfolios for financial institutions in Kosovo.

The initiative has shown itself to be suitable and to be improving the business environment, as well as the development and enhancement of the competitiveness of MSMEs in Kosovo.

Today, while drafting the first Annual Report for the FKGK, we analyze the achievements of last year in retrospect. They relate mainly to the legal operationalization and functioning of the institution.

Although seemingly simple, the journey to the realization of such a project was not easy, and entailed significant challenges.

From the very beginning, immediately after the emergence of the idea for our business model and the goals of the institution, the main challenge was the legal and organizational form it would take, the characteristics of the guarantees provided by the FKGK, and the question of who would be part of the team that would implement the initial ideas and take responsibility for the subsequent management of FKGK operations. The design of the loan guarantee scheme model was made by FKGK staff together with technical assistance provided by USAID's EMPOWER Credit Support Program, and drawing on the experience of representatives of the banking community, as well as of other stakeholders.

Determining the legal and organizational structure, based on best corporate governance practices, was a joint objective of all stakeholders, in order to create an institution with a sound basis. This marked the starting point for the drafting of the Law on the establishment of the Kosovo Credit Guarantee Fund.

The first fruits of this work were seen with the submission of the draft Law on the Establishment of the FKGK to the Assembly of the Republic of Kosovo in December 2015, and in January 2016 the law was approved, thus establishing the legal basis for the establishment of the FKGK as an independent legal entity. In addition, in December 2015, the Kosovo Investment and Enterprise Support Agency (KIESA) within the Ministry of Trade and Industry (MTI) transferred to the CBK trust account the first tranche of their contribution to the FKGK's capital, which marked the first step towards establishing the FKGK capital base.

Immediately after the approval of the law, the FKGK's corporate structure began to take shape, and after one month – in February 2016 – the Board of Directors was established as the highest oversight body of the FKGK. The first board meeting also took place this month, and the FKGK Statute was approved as the highest legal act within the institution.

Following a ceremony organized in April 2016 by USAID, through the EMPOWER Credit Support Program, and the Government of Kosovo, the FKGK was formally operational. This event, which also marked the creation of the FKGK as a local independent institution, was attended by respected state representatives, such as the President of the Assembly of Kosovo, Mr. Kadri Veseli; Prime Minister of Kosovo, Mr. Isa Mustafa; US Ambassador to Kosovo, H.E. Greg Delawie; German Ambassador to Kosovo, H.E. Angelica Veits; and Governor of the Central Bank of Kosovo, Mr. Bedri Hamza.

The Fund's operations continued with the signing of a Memorandum of Understanding with the Central Bank of Kosovo (CBK), in April 2016. This agreement established cooperation in information-sharing between the FKGK and the CBK. In May 2016, USAID entered into an agreement with the CBK for the provisional deposit of funds intended for capital contribution, for the benefit of the FKGK, which constituted the largest contribution to the capital base of the institution, destined to initiate credit guarantees.

Subsequent months saw the design of the application for database management, preparation of promotional materials, setting up the website and the organization of meetings with bank officials and the business community with the aim of informing them about the role of the institution and the services it provides. These activities helped promote the Fund as well as establish the institution's identity.

The first agreements with banks were signed in August, representing the final step in the process preceding the operational functionality of the FKGK. Thus, by the end of 2016, the FKGK signed agreements with nearly all banks active in the MSME sector, including Raiffeisen Bank, ProCredit Bank, NLB Bank, Bank for Business, TEB SHA, and Banka Ekonomike.

According to these agreements, banks will be able to transfer part of a borrower's credit risk as a result of collateral shortage and enable easier access to finance for such enterprises.

In parallel with the signing of the guarantee agreements with the banks, a series of orientation sessions were organized for the registered banks, with the aim of informing relevant credit staff about the FKGK – its establishment, role, purpose, organization, main principles of credit guarantees, and ways of working – and access to the FKGK Management Information System (MIS).

The first guarantees from the FKGK were registered in September, marking the moment when all the preliminary work on the institution's preparation came to fruition. The development of the loan guarantee portfolio continued systematically, and by the end of the year the FKGK had provided guarantees for 86 loans, with a total value of 1.9 million EUR, covering the outstanding loan amount of loans approved by registered Financial Institutions (RFIs) to a value of 3.9 million EUR

As with any institution in its early stages of operation, it is now that the real challenges emerge. The development of a stable, reputable institution that reflects trust in our partners remains a long-term institutional objective, and the development of our guarantee portfolio and active participation in facilitating the process of financial mediation is our raison d'être. However, the mission of the institution makes us optimistic and also responsible to give our most contribution to achieving these goals.

TIMELINE OF IMPORTANT ACTIVITIES IN 2016

2015	2016					
DECEMBER	JANUARY	FEBRUARY	APRIL	MAY	AUGUST	SEPTEMBER
MTI (KIESA) transfers to the CBK trust account the first part of the FKGK capital contribution	The Law on the Establishment of the FKGK is approved, thus establishing the legal basis for establishment of the institution	The constitution of the Board of Directors and the Statute of the FKGK is approved	FKGK launch event Memorandum of under-standing between the FKGK and the CBK	Agreement between USAID and the CBK for Grant Administration for FKGK capital contribution	Creation of FKGK MIS Signing of the first guarantee agreements with banks	Registration of the first credit guarantees by the FKGK

SPEECH BY THE CHAIRMAN OF THE BOARD OF DIRECTORS

During the last years, the financial sector in Kosovo, and the banking sector in particular, have demonstrated encouraging developments which have contributed to significantly increasing and enhancing private sector activities. While there has been continuous growth in lending to businesses and households, positive developments were also noted in launching new products to the market, especially in the automation of banking services, which has significantly improved the service quality for citizens.

In line with these positive developments in the financial market in Kosovo and with the aim of facilitating access to finance for small and medium enterprises, the Ministry of Trade and Industry within the government of the Republic of Kosovo established the Kosovo Credit Guarantee Fund, in coordination with the Central Bank of Kosovo and with USAID support.

Immediately after the establishment of the institution, through the approval of the relevant law by the Assembly of Republic of Kosovo, and with the assistance of USAID's EMPOWER Credit Support Program, everything was done to ensure that the FKGK became operational and could begin to provide credit guarantee as per its legal mandate. As a result of the commitment of all the partners involved in the process, including USAID, the Kosovo government, the Central Bank of Kosovo, and the German Development Bank (KfW), in 2016 the FKGK started issuing its first guarantees for the benefit of small and medium enterprises (SMEs).

The establishment and operation of the FKGK created significant expectations of this institution among all stakeholders, ensuring further enhancement of the banking sector. In line with its legal mandate and pursuant to the Law on the Establishment of the FKGK, CBK regulations and FKGK policies and procedures, the FKGK Board of Directors will ensure that in the months and years to come, the FKGK will have a significant role in the financial market in Kosovo. By offering credit guarantees for SMEs, the FKGK will contribute significantly to the facilitation of access to finance for these businesses, and make a direct impact on the economic growth of the country and in generating new jobs.

As this report is being drafted, almost all commercial banks in the country have been registered or are in the process of registration with the FKGK, and a number of them have already started using the credit guarantee provided by the FKGK. Considering the work done so far and our course set for the future, we are convinced that all banks will maximize the opportunities offered by the FKGK to facilitate access to SME financing.

The Board of Directors commits to ensuring that the FKGK has a key role in further development and advancement of the financial sector in Kosovo. In line with its mandate, the Board of Directors will ensure that, as provided in the Law on the Establishment of the Fund as an independent legal entity, the FKGK becomes a credible institution and, in the longer term, self-sustaining.

As has been the case until now with the efforts to consolidate and develop its functions, the FKGK will coordinate its activities with its potential and current partners, including USAID, the government of Kosovo, KfW, and the Central Bank of Kosovo.

HAJDAR KORBI
Chairman of the Board of Directors

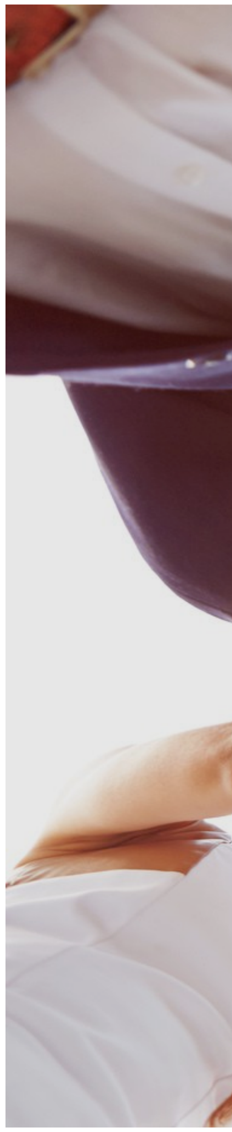
PROFILE OF THE INSTITUTION

Mission

The Kosovo Credit Guarantee Fund is an independent, development orientated legal entity that provides credit guarantees for MSMEs, by sharing the credit risk with financial institutions.

By guaranteeing the credit portfolios of financial institutions we aim to enhance access to finance for MSMEs, support entrepreneurship development, support domestic production and services that create an added value, create new jobs and support overall economic development.

We are committed to sustainable corporate management and the social responsibility that comes with it. Coordinating activities with our partners – donors, financial institutions and local regulators – we strive to serve the long-term economic interests of the country, the business community and our wider society.



Institutional Values

FKGK's values, which are institutionally embedded and serve to develop everyday business practices, provide guidance to ensure that our business activities have the highest level of accountability and are in line with the highest ethical and moral standards.

TRANSPARENCY:
Being an institution in the public interest, the FKGK believes that it is of the utmost importance to disclose information on working practices, policies and financial and operational results with partners and the general public.

PARTNERSHIP AND COOPERATION:
Developing sound relationships with our partners based on transparency and accountability helps achieve our common goals and develop credibility and mutual respect.

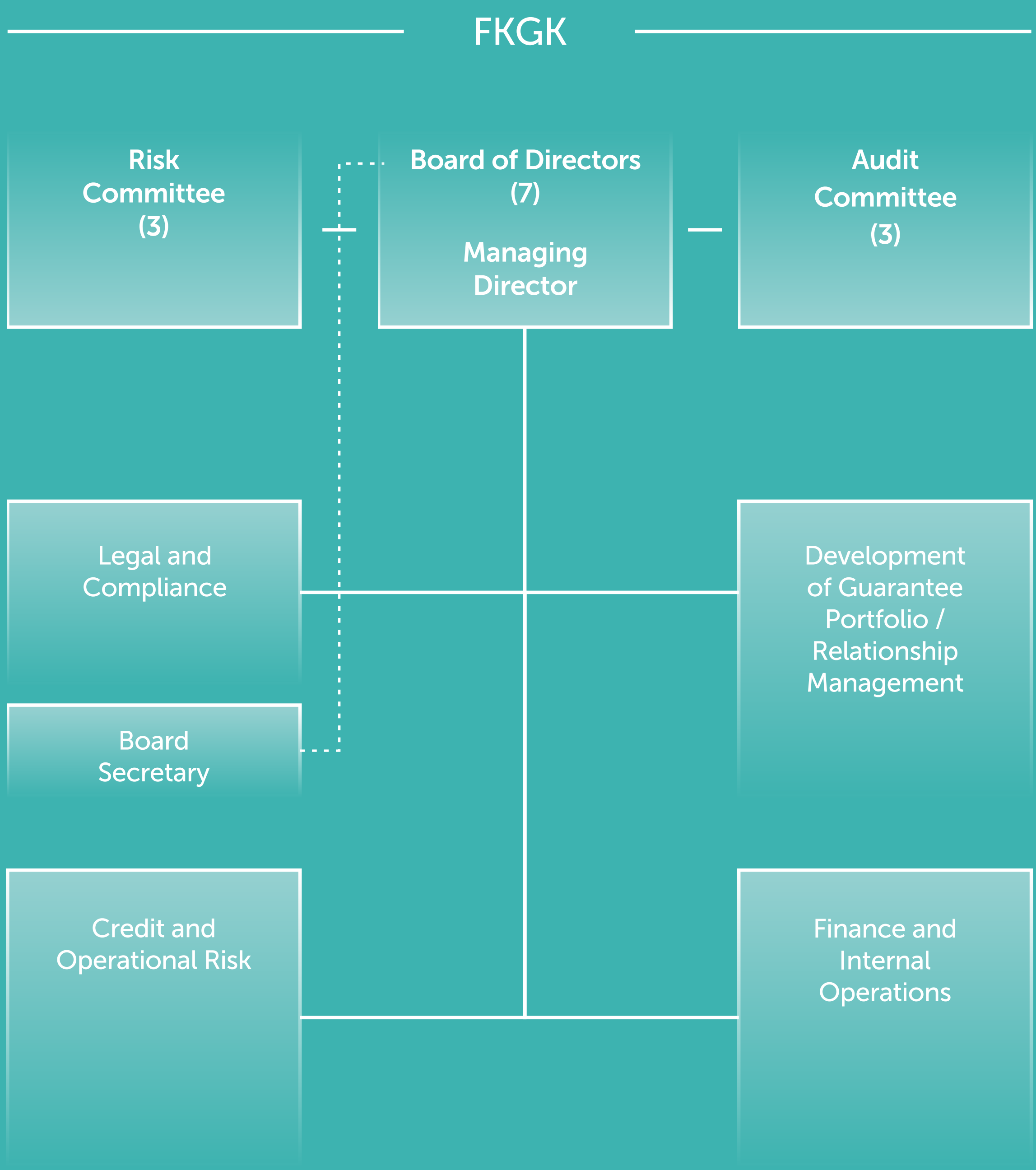
OBJECTIVITY AND INDEPENDENCE IN DECISION-MAKING:
The FKGK maintains its objectivity and independence in decision-making, based on sound reasons and principles, promoting further development of the financial sector.

COMMITMENT:
With dedication and professionalism, FKGK employees strive to fulfill the institution's mission and objectives, believing in the institution's role and the positive impact it will have on sound economic development.

TEAMWORK AND PROFESSIONALISM AT WORK
The FKGK has a team of experts who cooperate on the basis of mutual respect. Teamwork, problem-solving, open communication and sharing of professional experience create the foundation for the FKGK's success.

Every employee is expected to show integrity in the discharge of their duties and in the initiatives they take.

ORGANIZATIONAL STRUCTURE



BOARD OF DIRECTORS AND MANAGEMENT

In accordance with its founding legislation the Kosovo Credit Guarantee Fund, is governed by a Board of Directors consisting of seven members:

A. One ex-officio member appointed by the Ministry of Trade and Industry of the Republic of Kosovo;

B. One ex-officio member appointed by the Ministry of Finance of the Republic of Kosovo;

C. Four independent members, appointed by donors, and

D. The FKGK Managing Director.

HAJDAR KORBI, CHAIRMAN

Chief of Party, USAID "Partnerships for Development"

BAHRIJE DIBRA

Senior Sector Coordinator, Finance and Energy Sector, KfW Office Pristina

BESIAN MUSTAFA

Chief Executive Officer, Kosovo Investment and Enterprise Support Agency, Ministry of Trade and Industry, Government of the Republic of Kosovo;

SALVADOR ELMAZI

Head of Budget Department,
Ministry of Finance,
Government of the Republic of Kosovo

BESNIK BERISHA

Managing Director, FKGK

KRESHNIK KURTISHI

Deputy Chief of Party,
USAID Partnerships for Development

FKGK MANAGEMENT

From left to right.

ARTA KRASNIQI

General Counsel and Secretary to the Board of Directors

BESNIK BERISHA

Managing Director

VJOSA KELMENDI

Senior Finance and Office Manager

ALBAN KASTRATI

Senior Risk Manager

NORA ARIFI

Senior Guarantee Manager

The FKGK team is composed of professionals, each having more than 10 years previous working experience in other financial or public institutions. They are acutely aware of the issues affecting the financial sector in Kosovo, the legal system, and best lending practices, and possess sound knowledge about MSMEs, their nature and challenges and about opportunities in the market. All have the requisite educational background, either financial or legal, to match the requirements of their work at the FKGK.

In addition, each considers himself or herself to be part of a team that shares the same values and is driven by the same objectives: to serve the best interest of the institution ethically and professionally and to contribute to the economic development of the country.

FINANCIAL INSTITUTIONS

The FKGK aims to build a partnership with all financial institutions operating in the local market, including banks, non-bank financial institutions, and microfinance institutions.

The FKGK started its activity with the registration of commercial banks in the guarantee program, considering that banks have greater potential to develop a portfolio that would help the FKGK achieve its operational objectives, both quantitative and qualitative.

The banking sector has excess liquidity, in some cases invested abroad at a negative interest rate. The FKGK's guarantee facility can help unlock a substantial part of this liquidity and return it to Kosovo, to the benefit of MSMEs in Kosovo. This would ensure greater profitability for banks and would enable the FKGK to become a stable financial institution.

The process of registering banks in the FKGK began in April 2016. In early May 2016, banks started to submit their registration documents. By the end of 2016, six banks had registered and were eligible to enter into guarantee agreements with the Fund.

Banks registered in the Kosovo Credit Guarantee Fund by the end of 2016 were:

Banka për Biznes	NLB Bank	Raiffeisen Bank
Banka Ekonomike	ProCredit Bank	TEB SHA

FKGK PERFORMANCE

Capital Structure

At the end of 2016 FKGK capital stood at the level of 7,345,141 EUR as shown in the table below:

Donors	Original Donated Funds	%
USAID	5,345,141.07	72,77%
Ministry of Trade and Industry	2,000,000.00	27,23%
Total	7,345,141.07	100,00%

This amount, leveraged by a factor of five, and assuming a 50% guarantee, gives capacity for developing lending business up to at least 73 million EUR.

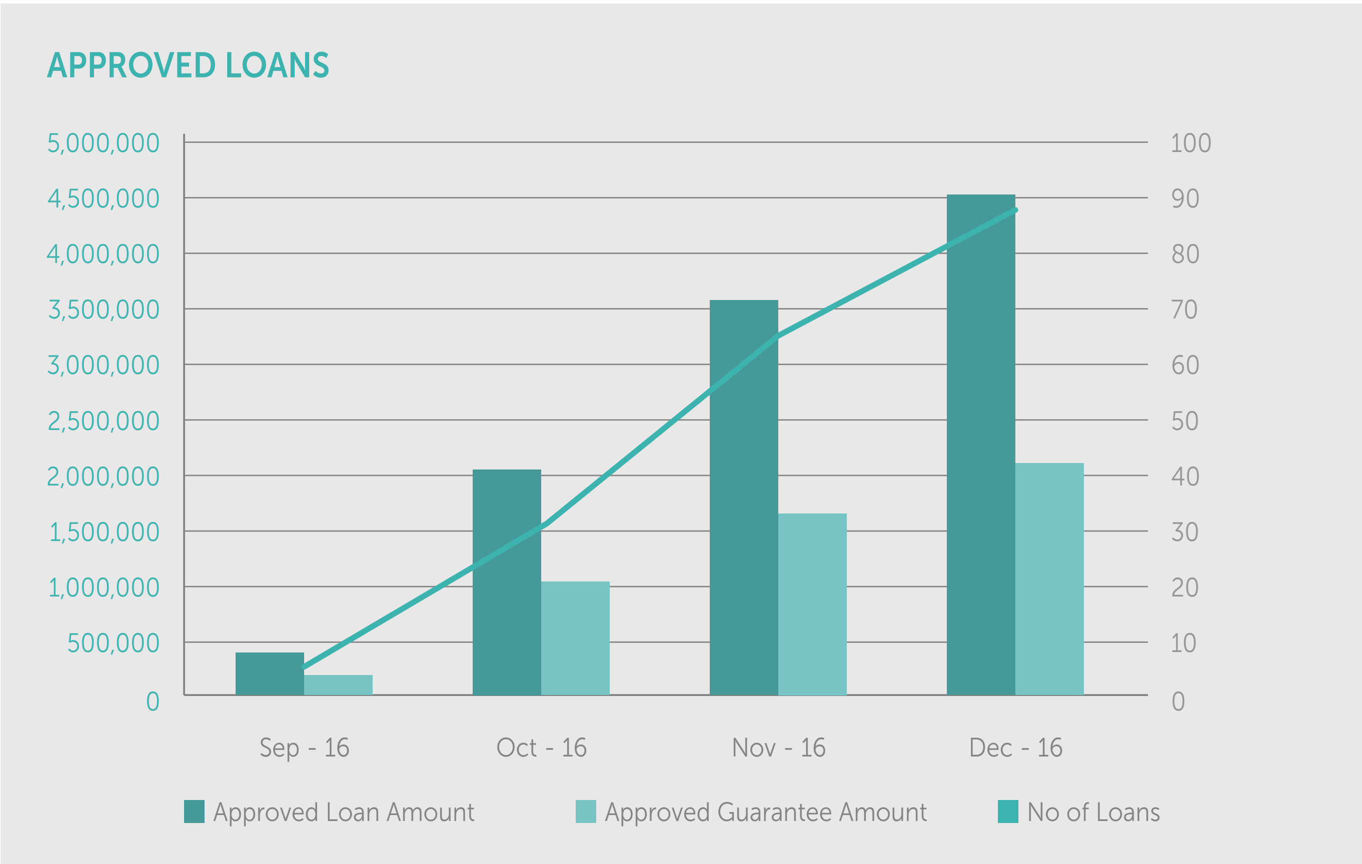
This amount would be the maximum outstanding portfolio at any given time, but because the FKGK is a revolving facility, the potential support and loan generation within a given period can be much higher.

By the end of 2017, as additional committed donor and Kosovo Government support is received, the capital of the FKGK is expected to reach 10.7 million EUR, strengthening the financial capacity and strength of the institution even further.

Use of the Credit Guarantee Service

The FKGK started receiving loans for guarantees from financial institutions at the end of September 2016. Despite the short period of time remaining during 2016, the FKGK saw a good start toward building its guarantee portfolio. This positive development within such a short period of time provided optimism for better results and developing more ambitious plans for the next year.

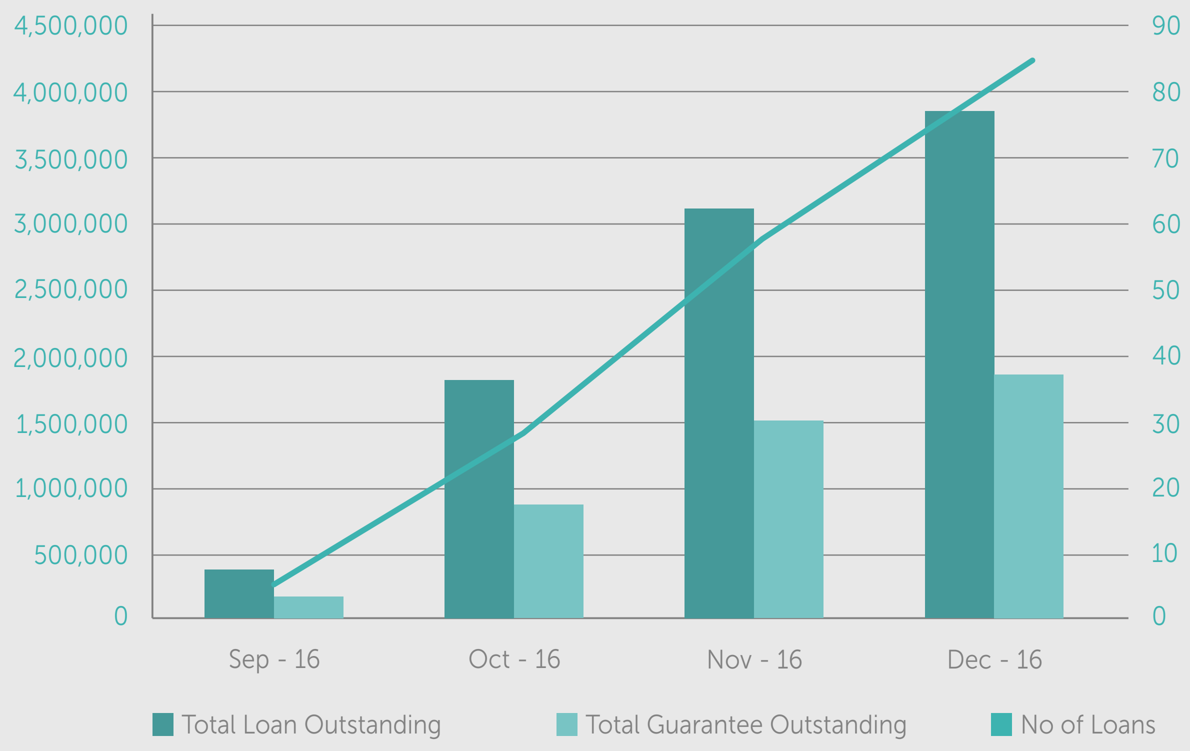
The total amount of loans approved by RFIs that were submitted under the guarantee during 2016 was 4.5 million EUR distributed in 86 loans; the guaranteed portion was 2.1million EUR, thus leaving room for significant expansion of the guarantee portfolio before available capital would be pressured.



The total amount of the outstanding loan portfolio approved for guarantee by the end of 2016 was 3.9 million EUR, distributed in 86 loans.

The total outstanding amount of the guaranteed portfolio was 1.8 million EUR. The portfolio showed high quality performance with no signals of deterioration.

OUTSTANDING PORTFOLIO



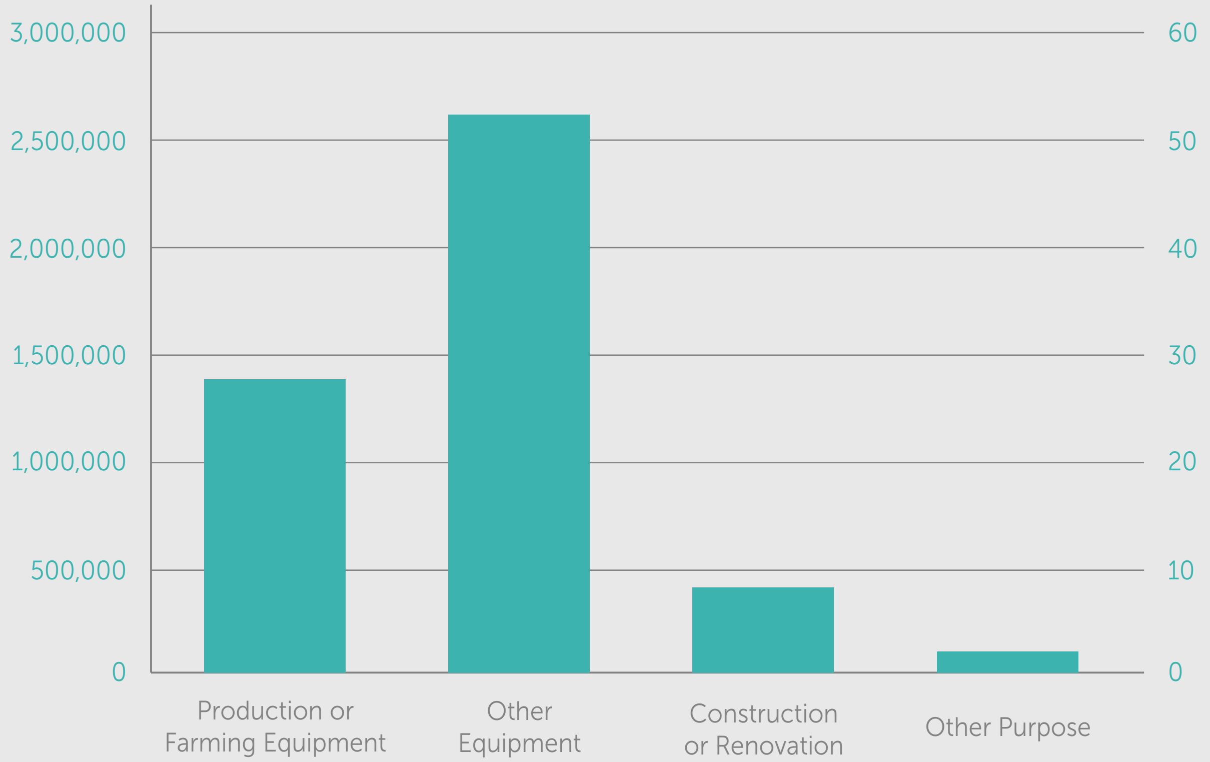
The average loan amount per client, at year end, stood at slightly below 50,000 EUR. This amount is indicative of the category of clientele which we believe most needs the support of the FKGK guarantee to overcome collateral barriers.

It is important to mention that our credit guarantee facility is focused toward the commercial enterprise segments (micro and small enterprises) that comprise the largest part of our country's private sector.

In terms of maturity, our guarantee portfolio is populated with medium-term loans. In terms of loan products, it mainly consists of installment loans, indicating that most of the loans disbursed under the guarantee had as their purpose investment in fixed assets.

58% of the approved loans were invested in equipment (production machinery, agriculture equipment, other equipment); 31% in land, construction or renovation; 9% in working capital needs; and 2% for other purposes.

PURPOSE OF THE LOANS

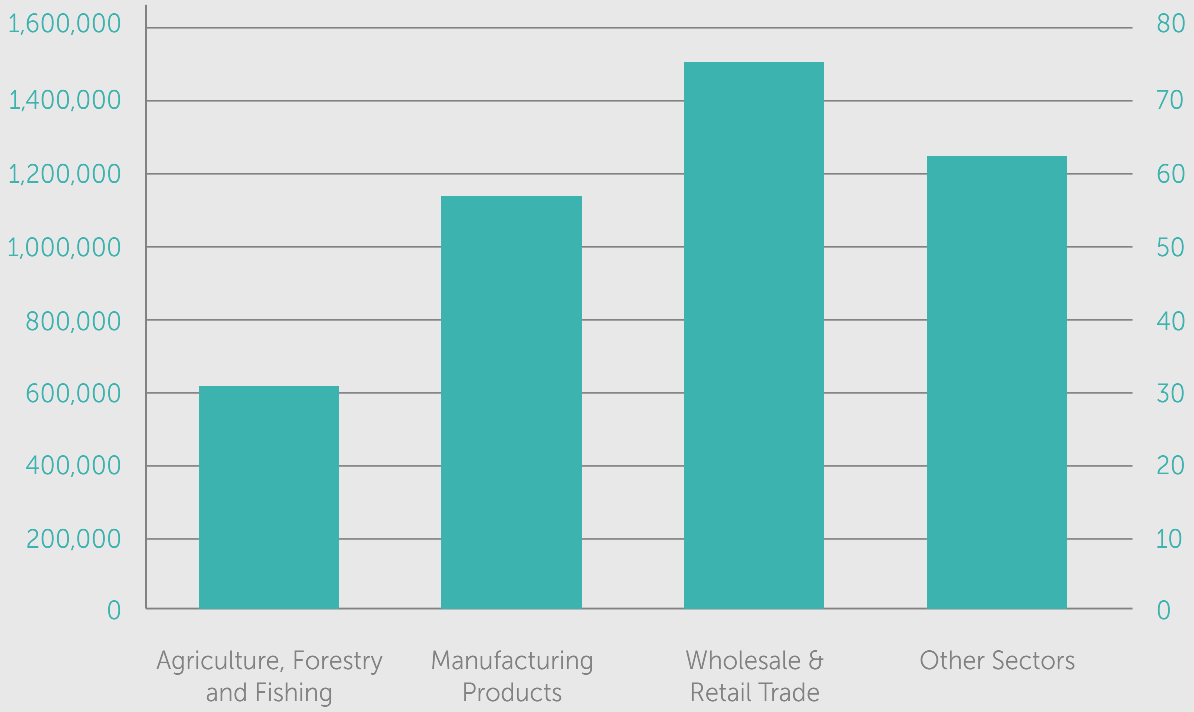


We believe that private enterprises in Kosovo, in all sectors – be they production, trade or service – need to be innovative and continuously improving their internal processes.

These companies will strengthen their competitive position in the local and international market by investing in new equipment, building premises or knowhow.

At the close of the reporting period, RFIs had loan guarantees across a broad range of business sectors, but the dominant sector (33%) was the retail and wholesale trade, followed by manufacturing (26%), crop and animal production (9%), and other sub-sectors making up 28% of the total guarantee portfolio.

MAIN SECTORS



The distribution of the FKGK's portfolio across different sectors reflects the country's economy. We believe that our economy should build its long-term sustainability on the sectors where it has comparative advantages.

However, it remains our objective to orient our efforts towards strengthening those sectors that create higher value for the economy and higher independence from imports. Stronger production and manufacturing sectors in the activities where our country has comparative advantage due to historical and natural developments will have a direct positive impact on the country's overall economic performance.

AUDITED FINANCIAL STATEMENTS

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.

Auditor's Responsibilities for the Audit of the Financial Statements (Continued)

- 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.

Pristina, March 3, 2017

BDO Kosova L.L.C.

BDO Kosova L.L.C.
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	8,209
TOTAL ASSETS		**7,387,820**
EQUITY AND LIABILITIES		
Current liabilities		
Accrual Guarantee Fees		35,609
Reserve for losses on Guarantees		10,219
Total current liabilities		**45,828**
EQUITY		
Capital	6	7,345,141
Accumulated loss		(3,149)
Total equity		**7,341,992**
TOTAL EQUITY AND LIABILITIES		**7,387,820**

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

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

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

	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	**7,345,141**	**(3,149)**	**7,341,992**

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

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

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

1. GENERAL

USAID Empower Credit Support Program (ECS) has been given the mandate to create the Kosovo Credit Guarantee Fund (KCGF). Through "Law on Establishment of the Kosovo Credit Guarantee Fund" Law No. 05/L -057 established the KCGF as an independent, not-for-profit, public institution, autonomous, legal entity and determined its authority, structure, governance, operations, scope, and policies and procedures for the issuance of Credit Guarantees.

KCGF is created to help meet the need for increased access to finance for micro, small and medium enterprises in Kosovo, in order to create jobs, increase local production and value added services, and improve the trade balance and enhance financing opportunities for MSMEs.

KCGF is an independent, autonomous, legal entity established by Law, with full legal personality, and a legal identity that is separate and distinct from the KCGF Management Board and Executives.

KCGF is governed by a Board of Directors composed of seven members who collectively combine years of experience in financial management, risk management, commercial or financial law and auditing. The Board provides leadership and oversight for all KCGF's activities.

KCGF is established for the purpose of providing partial risk credit guarantees to financial institutions on loans to MSMEs up to the coverage amount prescribed by the LKCGF and the Guarantee Agreement between KCGF and the financial institution.

For the purpose of its main function, KCGF is responsible for:

a. Issuing Credit Guarantees in accordance with the LKCGF and internal policies approved by the Board of Directors;
b. Setting the conditions for registering qualified Kosovo Financial Institutions in the KCGF reflected in the Policy on the Registration of Financial Institutions;
c. Setting the conditions for issuing Credit Guarantees by the KCGF.
d. Setting the Guarantee Fees of the KCGF.
e. Depositing or investing directly or through delegation of authority the assets of KCGF within the limitations of the LKCGF.
f. Paying Payable Amounts on Credit Guarantees to Registered Financial Institutions pursuant to the provisions of the LKCGF and the Guarantee Agreement, in accordance with the provisions of the LKCGF and the Policy on Handling Claims.

KCGF's minimum capital is 300,000.00 Euros as defined in the Article 10 of the LKCGF.
KCGF's governing bodies are the Board of Directors and the Managing Director. The Board of Directors shall be the highest governance body of KCGF.
The KCGF's fiscal identification number is 601642061.

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.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation and statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The financial statements have been prepared using the measurement bases specified by IFRS for each type of asset, liability, income and expense. The measurement bases are more fully described within the Note below.

The preparation of these financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Fund's accounting policies.

2.2 Changes in accounting policies and disclosures

The Fund applied, for the first time IFRS 1 and certain standards and amendments that are new standards issued by International Accounting Standards Board. Interpretations and amendments issued by the International Financial Reporting Interpretations Committee are effective for the first time for periods beginning on (or after) 1 January 2016.

Note: not all new standards and interpretations effective for the first time for periods beginning on (or after) 1 January 2016 effect the Fund's financial statements.

- IFRS 14 Regulatory Deferral Accounts;
- IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities and IAS 28 Investments in Associates and Joint Ventures;
- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture;
- IFRS 11 Joint Arrangements Amendments – Acquisitions of Interests in Joint Operations;
- IAS 1 Presentation of Financial Statements (Amendments – Disclosure Initiative)
- IAS 16 Property, Plant and Equipment (Amendments – Acceptable Methods of Depreciation)
- IAS 27 Separate Financial Statements (Amendments – Equity Method in Separate Financial Statements)
- IAS 38 Intangible Assets (Amendments – Acceptable Methods of Amortization);
- IAS 41 Agriculture (Amendments – Bearer Plants).

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 New standards, interpretations and amendments that are effective in periods after December 31, 2016 year ends

Below is a list of new and revised IFRSs that are not yet mandatorily effective (but allow early application) for the year ending December 31, 2016:

- IFRS 9 Financial Instruments;
- IFRS 15 Revenue from Contracts with Customers and related Clarifications;
- IFRS 16 Leases;
- IFRS 10 Consolidated Financial Statements Amendments – Sale or Contribution of Assets;
- IAS 12 Income Taxes Amendment – Recognition of Deferred Tax Assets for Unrealized Losses;
- IAS 7 Statement of Cash Flows Disclosure Initiative Amendments;
- Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions;
- IFRS 4 Insurance Contracts Amendment – Applying IFRS 9 Financial Instruments;
- IAS 40 Investment Property Amendment – Transfers of Investment Property;
- IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

The adoption of these amendments to the existing standards and interpretations has not led to any changes in the Fund's accounting policies.

2.3 Financial assets

The Fund classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity and available - for - sale financial assets. Management determines the classification of its investments at initial recognition.

Financial assets at fair value through profit or loss
Financial assets at fair value through profit or loss are financial assets held-for-trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Assets in this category are classified as current assets. The Fund has no assets classified in this category.

Receivables
Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets. As of the reporting date this category includes cash and cash equivalents.

2.4 Cash and cash equivalents

Cash and cash equivalents include cash in hand and balances with banks. The Fund has a bank account opened with Central Bank of the Republic of Kosovo.

2.5 Funds balance

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

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	Outstanding Amount of Loans	Outstanding Guaranteed Amount	Allocated Guarantee Amount Limit
		(EUR)	(EUR)	(EUR)	(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 Current			
	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	**7,379,611**	**7,379,611**
Financial liabilities		
Payables and other liabilities	45,828	45,828
Total financial liabilities	**45,828**	**45,828**

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	**7,379,611**

5. ACCOUNTS RECEIVABLE

	As at December 31 2016 (EUR)
Receivable from clients	8,209
Total receivables	**8,209**

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 that 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.

Kosovo Credit Guarantee Fund

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