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## Article

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EuroEconomica

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*Reference:* Dermaku, Arben/Peci, Bedri et. al. (2017). Review of accounting developments during 1945-2016 in Kosovo and challenges for the future. In: EuroEconomica 36 (2), S. 73 - 77.

This Version is available at:

<http://hdl.handle.net/11159/1747>

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## Review of Accounting Developments during 1945-2016 in Kosovo and Challenges for the Future

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**Abstract:** If we want to go back to history of accounting, we have to consider the socio-economic arrangements that Kosovo has undergone. Without pretending to make subjective conclusions on any socioeconomic system in this paper we have tried to consider the characteristics of accounting through different time periods in Kosovo. By separating the time periods, we pretend to evaluate and analyze the role of accounting. The first period includes the role of accounting up until 1990, the second period includes the role of accounting from 1990 until 1999, and the third period includes the role of accounting from 1999 until 2016. The research paper concludes that the trend of fair presentation of financial statements in a transparent and legal manner is growing even though there is a negative climate in relation to this trend. The main problem is lack of education in the financial sector in terms of reporting income and assets owing to a social economic system that did not promote awareness on good governance in the past. In that regard, the publically owned entities (POEs) demonstrate lack of financial transparency and accountability of not reporting their financial position and performance. Concerning the state of accounting we found a detrimental situation in the sense that the financial reporting was not done in regular basis. This was more emphasized in the transitory time period after the war from 1999 until 2009. The same issues with lack of transparency in POEs were prevalent also in the business or corporate community. POEs, however, were more sensitive for having endured the privatization process.

**Keywords:** Socio-Economic System; Accounting; Kosovo; Challenges

**JEL Classification:** M40; M41

### 1. The Period until 1990

The economic system in Kosovo since the World War II until 1990 was run by the former state of Yugoslavia. During that time period, a socialist type economy was developed. For our analysis, it is highly important to examine the role of accounting in former Yugoslavia and how that changed overtime in the 1990s from a socialist to a market economy.

In the time period of Yugoslavia (1945-1990) the state set in place strict policies in regulating accounting rules and principles. The legislation did not allow broader interpretations of the financial terms and results. Accounting was not as significant due to lack of a private or business mindset. That has affected the role of accounting in a very negative way. The purpose of accounting was more to use as a tool to evaluate the state of business.

In many cases, the state performed the analysis of financial statements and issued decisions that were highly political to cover for the deficit or other faults identified in the financial reports. This was against the international rules and standards of accounting. The chart of accounts served as the only guideline for bookkeeping and preparing of financial statements. Moreover, in this era, state funds were used to cover for financial losses reported by the businesses which in practice were controlled by the state. The

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state's influence over the business had negative effects. It reduced the work efficiency and innovation in terms of technology.

There were businesses which have been profitable for being in a better position in a particular economic sector. However, the pricing policies were still set by the state that in most part were damaging to the business community and market economy in general. Consequently, many businesses started to encounter financial losses instead of making profits. It was ultimately up to the state to decide on the rule in market economy which in most part were based on development policies which at the time led to negative effects in the economy.

The role of accounting in this time period was extremely weak since the state had a bigger role in the business community. The financial reports were not prepared by businesses and the legislation was not comprehensive as far as protecting economic activities including bankruptcy rights for businesses.

## **2. The Period from 1990 until 1999**

The economy of Kosovo did not grow well in 1990s since it experienced a political turmoil of the Serb occupation where the market economy was almost inexistent. The segregation of Albanians and the war in 1998 affected the economic life. Citizens were required to pay liabilities to the state of Serbia and the parallel institutions of Kosovo which were run mainly by the Albanians. It is almost impossible to describe the dire state of economy in the 1990s when Albanians had limited rights to political and economic institutions.

This is the time period when Yugoslavia was breaking apart and had already experienced the war in Bosnia and Croatia which ultimately resulted in the independence of Slovenia, Croatia, Bosnia and Macedonia. It took longer for the war to break in Kosovo after the Serbian gov't learned its lessons of repressing the Albanian population instead of waging a direct war. It took serious steps from an economic perspective of reorganizing of business entities and expelling Albanian employees from the state/public institutions.

In this time period, accounting grew more as a profession and discipline in the professional life despite the fact that the economic system experienced direct threats from the Serbian government. The economic entities maintained the books for the audit purposes required by the Serbian authorities and merely for private purposes since economic entities came to realize the importance of auditing of financial statements. There was a limited number of economic entities which were organized as corporations since most of them were individual businesses. To that effect, the development of accounting tool longer than the usual.

## **3. The Period from 1999 until 2016**

The repression of Albanians ultimately led to the war in 1999 in response to the Serbian regime. Once it ended, the economy had to build from scratch. It was characterized by lack of formal state institutions which meant that businesses were free from tax and financial obligations to run their activities and maximize their profits. It is usually normal for businesses to operate in illegal forms as it was the case right after the war. However, this created lasting negative effects and unfavorable economic conditions in the long-term. Meanwhile, government institutions were established over time and grew more competent in terms of regulating business environment and creating a more normal functioning economy.

In terms of accounting, financial reporting was not done in regular basis especially during the time period from 1999 until 2009. This was problematic in almost all types of economic entities such as



socially owned enterprises and public or private institutions. Financial reporting became an issue in the process of privatization of socially owned entities. The privatization process did not meet its goals according to our analysis with regards to increasing efficiency and creating jobs.

The Kosovo Privatization Agency (KPA) has been criticized for not being transparent as far as financial reporting to be able to assess the value of privatized entities. To that effect, economic entities were managed poorly without any performance assessment being conducted. In analyzing the failures of managing social properties, many consider that there were ill intentions of reducing the value of privatized entities for private gains and abuse of the process in general.

It is almost a similar situation with the Publically Owned Entities (POEs) when it comes to lack of transparency and accountability. POEs did not report their financial activities as a way for those in political power to find ways to decrease the value of these entities prior to privatizing them. With the case of the telecom entity Post Telecommunication of Kosovo (PTK), the policy of the government to transfer a specific cash amount from PTK to the state budget was not a bad decision since it led to the fall of the value of the telecom entity which led to a price reduction. Basic accounting indicates that if the value of assets is large then the sale prices would be higher and the other way around.

With regards to the role of accounting the private sector, it is required that private entities are transparent in reporting their financial statements and performance. Here we refer more to the businesses with a single owner (sole proprietorship) since there were only few businesses with more than one owner. According to our analysis, sole proprietorship firms are not transparent in reporting their financial statements and performance. Financial reporting is better conducted in corporations, however, since it is mandatory. In the last years, financial reporting has improved and now it is treated as mechanisms of regulating business activities in a more transparent manner.

The Law on Financial Reporting in Kosovo was approved for the first time ever in 2011. Its preparation and approval by the assembly of Kosovo took almost seven years. 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 Central Bank of Kosovo. The new law was expected to contribute to the alignment of the corporate reporting framework with the European Union Directives. Although, it fell short of this objective, the new law does represent an improvement on the UNMIK Regulation. The Law on Financial Reporting is silent on the use of Kosovo Accounting Standards (KAS), although it holds the Council for Financial Reporting responsible for maintaining KAS. This has created confusion in the market place. 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. 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.

Filing of annual company financial statements is required by law. 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. Consolidated financial statements have to be submitted to the Council for Financial Reporting, no later than 30 of June of the following year. 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 and this is one of the greatest challenges of the futures of financial reporting profession in Kosovo.

Some of the challenges of financial reporting that need to be addressed very urgently in order to increase the transparency and trust in the financial statements are:

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- Enforcement of the requirement to publish financial statements;
- Definition, monitoring and enforcement of professional pre-qualification experience for statutory auditors;
- Establishment of a public register of statutory auditors and audit firms, containing all the information required by the EU's Statutory Audit Directive;
- Implementation of the quality assurance program;
- Review of the current criteria concerning the obligation to have a statutory audit;
- Monitor the application of IFRS, in both the financial and non-financial sectors

#### **4. Conclusion**

The business community has grown more transparent in terms of making their financial statements more open although there is still challenges down the road. The level of education of business owners and managers is critical of setting the business on track as far as financial reporting. Here is the main problem since there is overall lack of institutional knowledge in the realm of financial reporting due to the previous socialist economic system. In a socialist economy, financial information with regards to assets, liabilities, equity, revenues and expenditures were not open for the public. This is because the state owned economic entities and decided to not reveal information for political reasons.

The top priority that should be considered to inspire businesses to become more transparent is to increase the awareness on financial reporting. Advanced training programs tailored for financial reporting should be developed from elementary and secondary schools to higher educational institutions. More students should know how to prepare financial reports and assess financial performance of public and private entities. In these programs, the role of private property should be emphasized and how that connects with the socio-economic development.

In addition, it is also important to think how financial reporting can be presented to the general public through press and audiovisual means. In that case, the benefits of fair and reliable financial reporting must be emphasized and how financial reporting is key in terms of assessing the financial performance and dynamics of private entities. The current law of financial reporting, accounting and auditing must be changed in order to be aligned with European Union Directives. One of the main challenges remains proper implementation of International Financial Reporting Standards and publication of financial statements to be accessible by wider audience.

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