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**ZYRA KOMBËTARE E AUDITIMIT
NACIONALNA KANCELARIJA REVIZIJE
NATIONAL AUDIT OFFICE**

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AUDIT REPORT

**ON THE ANNUAL FINANCIAL REPORT OF THE PUBLICLY
OWNED ENTERPRISE DISTRICT HEATING GJAKOVA JSC**

FOR THE YEAR ENDED 31 DECEMBER 2016

Prishtina, June 2017

The National Audit Office of the Republic of Kosovo is the highest institution of economic and financial control which, according to the Constitution and domestic laws, enjoys functional, financial and operational independence. The National Audit Office undertakes regularity and performance audits and is accountable to the Assembly of Kosovo.

Our Mission is to contribute to sound financial management in the public administration. We perform audits in line with internationally recognized public sector auditing standards and good European practices.

The reports of the National Audit Office directly promote accountability of public institutions as they provide a base for holding managers' of individual budget organisations to account. We are thus building confidence in the spending of public funds and playing an active role in securing taxpayers' and other stakeholders' interests in enhancing public accountability.

The Auditor General has decided on the audit opinion on the Annual Financial Statements of the Publicly Owned Enterprise District Heating Gjakova JSC in consultation with the Assistant Auditor General, *Vlora Mehmeti*, who supervised the audit.

The opinion and report issued are a result of the audit carried out by Luljeta Morina and Senver Morina under the management of the Head of Audit Department, Enver Boqolli.

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Executive Summary

Introduction

This report summarises the key issues arising from our audit of the 2016 Annual Financial Report of the Publicly Owned Enterprise District Heating Gjakova JSC, which determines the Opinion given by the Auditor General. The examination of the 2016 financial statements was undertaken in accordance with the International Standards on Supreme Audit Institutions. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The applied audit approach is set out in our External Audit Plan¹ dated 28/10/2016.

Our audit focus (detailed in Annex 1) has been on:



The level of work undertaken by the National Audit Office to complete the 2016 audit is a direct reflection of the quality of internal controls implemented by the Management of the Central Heating.

Opinion of the Auditor General

Qualified Opinion

Except for the effects of the issues described in the Basis for Qualified Opinion paragraph, the Annual Financial Statements for the year ended on 31st of December 2016 present a true and fair view in all material respects.

Other issues

Annual Financial Statements of the District Heating for the year ended on 31st of December 2015 have been audited by another auditor.

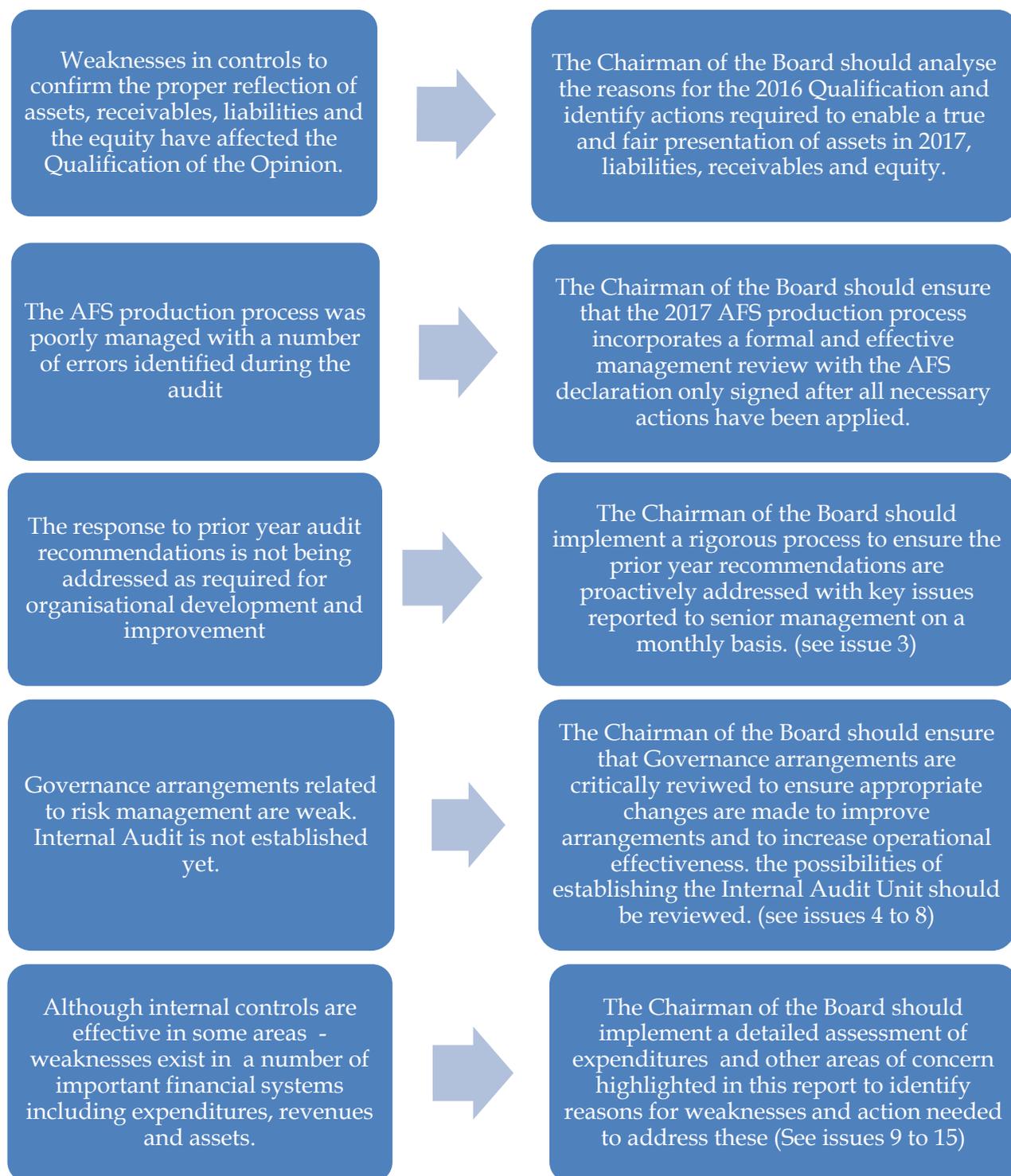
For more, please refer to Section 1.2 of this report.

Annex II explains the different types of Opinions applied by the National Audit Office.

We would like to thank the Chairman of the Board and his staff for the cooperation during the audit process.

¹ The term External Audit Plan replaces the term Audit Planning Memorandum

Key Conclusions and Recommendations



Response of the Chairman of the Board – 2016 audit

The Chairman of the Board has considered the detailed audit findings and conclusions in this report and has committed to address all given recommendations.

1 Annual Financial Statements and other External Reporting Obligations

Introduction

Our review of the Annual Financial Statements (AFS) considers both compliance with the reporting framework and the quality and accuracy of information recorded in the AFS. We also consider the Declaration made by the Chief Executive Officer (CEO) and Chief Financial and Treasury Officer (CFTO) when the draft AFS are submitted to the Board of Directors.

The declaration regarding presentation of the AFS incorporates a number of assertions relating to compliance with the reporting framework and the quality of information within the AFS. These declarations are intended to provide the Shareholder and the public with the assurance that all relevant information has been provided to ensure that a comprehensive audit can be undertaken.

1.1 Audit Opinion

Qualified Opinion

We have audited the AFS of the District Heating for the year ended on 31st of December 2016 which comprise of the Balance Sheet, Statement of Incomes, Cash Flow Statement, Statement of Changes in Equity and the Explanatory Notes.

In our opinion, except for the effects of the issue described in the Basis for Qualified Opinion paragraph, the Annual Financial Statements for the year ended on 31st of December 2016 present a true and fair view in all material respects of the POE in accordance with International Accounting Standards (IAS), International Financial Reporting Standards (IFRSs) and Kosovo Laws. The financial statements have been prepared based on accrual accounting principle, Law no. 03/L-048 on Public Financial Management and Accountability (as amended and supplemented) and Law no. 04/L-087 on Publicly Owned Enterprises (as amended and supplemented).

Basis for Qualified Opinion

We have created the basis for a qualified opinion for the following reasons:

- Out of the 35 letter confirmations sent, we received only six confirmations, one contains the annual turnover only, while the other three are overstated by the amount of €34,982 and the other two understated by €6,513. This is because no proper reconciliations have been made or some of the customers have not reported old debts in the absence of records. This does not provide the assurance that the cash receipts provide an accurate and complete balance of stock.

- Another short-term obligation was presented in the AFS of 2016 as €78,737 related to the corporate tax liability which dates since 2012, 2013, 2014 as a backlog due to the failure to settle the debt in time. This situation has changed, increased for the tax on profit from the initial value of €55,147 as a consequence of the control by the Tax Administration of Kosovo (TAK) due to the inadequate calculation of the depreciation expenditures for the previous years and we cannot provide assurance for the initial balance of this account.
- The value of debt owed for consumption of electricity from previous years does not match between billing of supplier and accounting. According to the supplier's file, the calculation of debt in accounting was €119,131, while according to KEDS/KEK invoices it was €114,388 (this debt was mostly not paid to KEK). The overstatement of €4,743 resulted from accounting errors made in the past and in absence of analytical records up to 2010, the District Heating faced difficulties in applying reconciliation with the supplier.
- The District Heating for Water expenses in Accounting presented an outstanding obligation in the amount of €47,009, which does not match the debt evidenced in invoices according to the supplier €51,039. In accounting, the paid account has an understatement of € 4,030. This was due to the lack of evidence from the past and changes to the accounting software in 2010 where analytical evidence was not incorporated but only the situation, which causes difficulties in reconciliation between the parties.
- The enterprise failed to update the asset register and in t absence of a complete register we are not able to obtain assurance for the value of the asset.

We conducted the audit in accordance with International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the AFS section of our report. NAO is independent of the POE in accordance with the ethical requirements that are relevant to our audit of the annual financial statements of Budget Organisations and POEs in Kosovo and we have fulfilled other ethical responsibilities in accordance with these requirements. We believe that the obtained audit evidence is sufficient and appropriate to provide a basis for the qualified opinion.

Other issues

The Annual Financial Statements for the year ended 31st of December 2015 have been audited by another auditor, who has expressed a qualified opinion on these financial statements on 18 April 2016 due to disclosure: in the note seven (7) for the inability to collect receivables; In note eight (8) non-compliance of other receivables with the TAK balance; and in note 14 for discrepancies between the CGS and the balance of TAK.

Responsibility of Management and Those Charged with Governance and AFS

The Chairman of the Board of District Heating is responsible for the preparation and fair presentation of financial statements in accordance with International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and Laws of Kosovo, as AFS have been prepared under the accrual² basis of accounting, 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. This includes the application of Law number 03/L-048 on Public Finance Management and Accountability (as amended and supplemented) and Law no.04/L-087 on Publicly Owned Enterprises (as amended and supplemented).

The Chairman of the Board is responsible to ensure oversight of the X POE's financial reporting process.

Auditor General's Responsibility for the Audit of the AFS

Our responsibility is to express an opinion on the AFS based on our audit. We conducted our audit in accordance with ISSAIs. These standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs 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 influence the decisions taken on the basis of these AFS.

An audit involves performing procedures to obtain evidence about the financial records and disclosures in the AFS. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement in the AFS, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the entity's circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the presentation of the financial statements.

² Accrual Principle - Recognising Transactions and Events is reported when they occur and not when cash is received or paid.

1.2 Compliance with AFS and other reporting requirements

POE is required to comply with a specified reporting framework and other reporting requirements. We considered:

- Requirements of Law no.03/L-048 on Public Financial Management and Accountability (as amended and supplemented);
- Requirements of the Law no.02/L-123 on Business Organisations;
- Requirements of the Law no.04/L-087 on Publicly Owned Enterprises (as amended and supplemented);
- Requirements of the Law no.04/L-104 on Accounting, Financial Reporting and Auditing;
- Requirements of the Law on Public Procurement (as amended and supplemented);
- Requirements of the Instruction no.2/2013/MF on the Structure and Content of Annual Financial Reports.

In the context of other external reporting requirements, District Heating is also required to prepare the following reports:

- Charter of the POE;
- Business Plan;
- Quarterly reports in time;
- Performance (operational) in time;
- Annual Report
- Customer Satisfaction Report; and
- Draft plan and final procurement plan in time.

In our Interim Audit Memorandum, dated 23/12/2016, we have raised some issues regarding the financial statements that may have an impact on the opinion. Issues raised were not fully addressed. Consequently, some financial adjustments were required in the financial statements as of 15/02/2017, in the statement of financial position, income statement, statement of changes in equity and explanatory notes that were followed with some errors. Despite our suggestions to make the necessary actions, we have identified the findings that we have presented to the basis for the opinion.

Taking into account the above, the AFS prepared by the Chief Executive Officer and the Chief Financial Officer on their submission to the Board of Directors may be considered as accurate except for the issues that have been identified on the basis of the opinion.

In the context of other external reporting requirements, the District Heating met the above requirements, except for the Customer Satisfaction Measurement Report which was not yet been finalised.

1.3 Recommendations for the first part of the report

Recommendation 1 High Priority- The Chairman of the Board should ensure that an analysis is undertaken to determine the causes which had an impact on giving an Qualifying Opinion. Actions should be taken to address the underlying causes in a systematic and pragmatic manner to remove errors and ensure accurate estimation of receivables, payables and assets.

Recommendation 2 High Priority- The Chairman of the Board should ensure that effective processes are in place to confirm that the 2017 AFS production plan formally addresses all compliance issues. This includes Management review of the draft AFS with specific focus on high risk areas and areas where errors have been identified in previous years. AFS should be approved if all necessary checks have been applied.

2 Governance

Introduction

Effective governance arrangements are fundamental to District Heating for successfully managing the challenges it faces and ensuring that service delivery is optimised for the benefit of taxpayers and other service users.

A key tool supporting effective Governance is the implementation of audit recommendations as this demonstrates that Management are seeking to develop existing processes and controls. We have therefore applied a consistent approach across all audits to determine the quality of reports of different units individually and of the Enterprise in general.

The remainder of our review of governance arrangements reflects a consideration of:

- those areas of governance arrangements where significant improvements are required and where we believe that our recommendations can generate positive improvements including consideration of the Internal Audit system, allocation of duties, fulfilment of customers' requests (satisfaction); and
- areas of Financial Management and Control identified through our audit work including specific work directed at compliance issues in key income and expenditure systems (these areas are considered in Section 3 of this report).

Overall Governance Conclusion

There is a number of governance weaknesses within District Heating particularly related to risk management. Different reports completed by the District Heating only partially recognises this situation with some positive comments about existing arrangements evidence based. Other arrangements which would support the development of governance such as an effective response to audit recommendations and the operation of an internal audit system are not in place.

Governance in District Heating regarding management reporting and accountability and risk identification reflects a positive situation. However the District Heating did not manage to implement all recommendations and did not prepare a risk management plan, despite that several significant risks that might affect the Enterprise in achieving its objectives have been identified. The Internal Audit was not established and this does not provide a clear picture of the level of assurance of internal controls.

2.1 Progress in the Implementation of Prior Year Recommendations

Our External Audit³ Report on the 2015 AFS of District Heating resulted in four (4) key recommendations. The District Heating did not prepare an Action Plan stating how all recommendations will be implemented.

By the end of the year the District Heating managed to implement one (1) recommendation while three (3) other recommendations were in process of being implemented. Only the recommendation regarding the reconciliations between the item for receivable taxes (requirements against TAK) and the balance of TAK were fully implemented. While the other three recommendations related to the analysis of uncollectable receivables, the reconciliations in the income statement for the Cost of Goods Sold (CGS) with that presented in the TAK's report, and the setting of a cash register maximum for holding cash, were partially implemented.

For a more thorough description of the recommendations and how they are addressed, see Annex III.

Issue 3 – Implementing Prior Year Recommendations – High Priority

Finding	By the end of the year, the District Heating managed to implement one (1) recommendation, while three (3) other recommendations were in process, because the District Heating is not following a formal process to manage and monitor the way external audit recommendations are implemented.
Risk	The partial implementation of the recommendations increases the risk of continued presence of the same shortcomings that relate to the annual financial statements.
Recommendation 3	The Chairman of the Board should ensure that the action plan is prepared and implemented, if the need appears, the same plan should be reviewed by specifying timetable in time for the implementation of the recommendations made by the External Auditor with the accountable staff identified, with initial focus on areas of significance.

2.2 Specific Governance Reviews

Our work on specific areas of governance arrangements has been informed by our audit planning which considered the context within which the District Heating operates and the challenges that it faces.

³ Raporti i auditimit të jashtëm - Auditimin e PFV të Ngrohtores për vitit 2015 e kishte bërë një kompani private audituese dhe jo ZKA, dhe raportimi i tyre ka përfshirë një raport me opinionin dhe një letër për menaxhmentin ku janë prezantuar të gjeturat me rekomandime.

2.2.1 Setting of Strategic Objectives

Pursuant to the Law on Publicly Owned Enterprises, the District Heating should prepare a Business Plan for the coming calendar year. This plan should be approved by the Board of Directors up to 31st of October of each calendar year.

Issue 4 – Shortcomings in the Business Plan – High Priority

Finding

According to the Law on Publicly Owned Enterprises, the District Heating until 31st of October of each calendar year should prepare a Business Plan for the upcoming calendar year. However, although the business plan is designed, it does not cover all activities and its contents do not reflect the real opportunities of the enterprise. The business plan contains a SWOT⁴ analysis describing the strengths, weaknesses, opportunities and threats, but not a risk management plan, especially those that depend directly on the activities of the enterprise and have a greater impact and higher likelihood of occurrence. This situation resulted from a financial inability to manage situations as higher investments in existing assets, high price of fuel, impossibility of increasing tariffs set by the Energy Regulatory Office.

The management developed uninterrupted activities to secure investments and expectations for new investments are close because the District Heating has just won a grant from the EU as IPA II⁵ worth € 21 million along with Termokos for improving central heating co- generation. Also, the division of the parcel for the construction of the plant was done by the Government of Kosovo with the decision of 30.09.2016. The problem remains the rehabilitation of the primary thermophilic network and substations, which requires additional means and the management of the enterprise is making continuous efforts to provide funds for this project.

Finding

Identified shortcomings will weaken the quality of service to citizens if internal and external issues affecting this are not addressed in a timely manner. Limited revenues, aging and high value of debts and receivables that most have been inherited from the past are factors that increase the risk of normal operation of the enterprise and have a direct bearing on the management of the risks identified.

Recommendation 4 The Chairman of the Board should ensure that all mechanisms are used to address identified issues and make risk management efforts more appropriately to reduce them to an acceptable level.

⁴ SWOT Strengths, Weaknesses, and Opportunities, Threats

⁵ IAP -The Instrument for Pre-Accession that the European Union (EU) allocates to states that aspire to become EU members

Issue 5 - Failure to complete the Heating services - High Priority

- Finding** The supply with raw materials for the provision of thermal heating is made by the subsidy of the Government, respectively the Ministry of Economic Development but due to the financial difficulties, the District Heating is not able to provide sustainable heating for the consumers throughout the season request according to the Law for thermal energy (Article 11.1). This year the thermal energy supply started on 01.12.2016 for the winter season due to lack of raw material and problems with the aging of production equipment and distribution network.
- Risk** Shortcomings identified have resulted in non-compliance with legal requirements and poor service delivery.
- Recommendation 5** The Chairman of the Board should ensure that additional activities are undertaken to provide the necessary means to meet the quality of the heating service.

Issue 6 - Weakness in Realistic Measurement of Thermal Energy Utilization - High Priority

- Finding** Lack of heat metering equipment was another obstacle for a real billing and real charge on customers. This should serve as a basis for realistic measurement of thermal energy utilization and real billing to customers. According to the law on thermal energy no. 05/L-052 (Articles 9.2, 30 and 35.1) requires that the Distribution System Operator installs metering devices for customers connected to the thermal power system within five (5) years after the entry into force of this Law. However, this requirement was not yet met due to financial difficulties while billing still continues with the method of setting tariffs for unmetered customers, based on estimated square meter of premise (the premises are measured by a commission from District Heating).
- Risk** Incorrect measurement of thermal energy increases the risk of incorrect billing and customer rejection to pay the bills.
- Recommendation 6** The Chairman of the Board should ensure the compliance with legal requirements for installing thermal energy metering equipment at each customer for the purpose of charging and billing accurately.

2.2.2 Management Reporting and Accountability

A range of internal controls are applied by Management to ensure that financial systems and operational activities operate as intended. It is important that these include appropriate reporting to management to enable an effective and timely response to identified operational problems.

Issue 7 - Weaknesses in Management Controls - High Priority

Finding Our review of the management controls applied to District Heating's key financial system highlighted a financial reporting of expenditure and revenue to senior management and an analysis of service delivery. However, these reports have not always been complete and accurate for liabilities, receivables, assets and equity. This is because the inherited accounting records that have not been updated in time and even after our advice in the audit memorandum have provided incomplete and inaccurate reports on these categories.

In addition, identified weaknesses indicate that management controls are not yet sufficiently consolidated to prevent or avoid eventual errors. Further on, the failure to fully implement prior year's recommendations and the lack of IAU are indication that controls are not being applied effectively.

Risk Quality of financial and activity reporting to senior management has reduced the management's ability to proactively manage the operations of District Heating and undermines effective control. The identified shortcomings may result in inaccurate and incomplete reports for users.

Recommendation 7 The Chairman of the Board should ensure that a review is implemented to determine the format of financial and operational reporting to senior management which is required to support effective business management and ensure that an appropriate solution is found.

2.3 Internal Audit System

The Internal Audit System is a key part of internal control and because of its importance we presented here separately. We take into account the scope of the internal audit work and the activities of the Audit Committee. In addition, we consider the actions undertaken by senior management as a result of the work done by the internal audit and audit committee.

Issue 8 –Failure to Establish IAU - High Priority

Finding The District Heating did not have the IAU established, although this year included the staffing as objective, and foresaw the position of the internal auditor to be completed in January of this year. Due to financial reasons and in absence of qualified candidates applying according to the competition at the end of the year, the same position remains uncovered. This reflects the lack of management’s attention in recognising and maximising the benefit of internal audit to seek assurance on the effective functioning of internal controls or good governance.

Risk Lack of IAU reduces the management’s ability to the functioning of financial systems. This results in unidentified weaknesses and continuation of ineffective practices that may also result in financial losses for the District Heating.

Recommendation 8 The Chairman of the Board should consider providing an internal audit service in order to test the adequacy, effectiveness of the system Financial management and the operation of controls within the District Heating.

3 Financial Management and Control

Introduction

Our work on Financial Management and Control (FMC) outside of the areas of Governance referred to Section II reflects the detailed work undertaken on Revenue and Expenditure Systems in the District Heating. As part of this, we consider Budget management, Procurement and Human Resources issues, and Assets and Liabilities.

Financial Management and Control Conclusion

The existing controls over the financial management of the District Heating need to be improved. Existing budget planning processes are not adequate, they have not taken into account the causes that may occur during the year questions the achievement of the objectives and the inability to cover the costs. And for that, there were differences between initial and final budget planning for wages and salaries and goods and services.

Controls in the area of revenues from its main activity were better compared to the previous year. The District Heating managed to execute 99% of the revenue plan for 2016. In spite of this, the District Heating is operating at a loss as a result of low tariffs and high cost of services which cannot be covered by collected revenues.

Further on, the audit identified shortcomings in employee payroll management and human resource management. The District Heating continuously fails to pay the employee's salary bill due to liabilities from previous years. Similarly, the lack of an employee's assessment reflects the impossibility of measuring performance and puts in question proper performance of contracted obligations. Controls in management of goods and services appear to be good, but further work should be done to ensure the goods are received through Receiving report to ensure that the goods/services/works are accepted according to the financial bid, contract specifications.

Despite the activities undertaken by the District Heating, the value of receivables and liabilities remains high. The high value of liabilities and the financial inability to settle these liabilities represent the position of financial difficulty for developing a normal business activity.

These and other weaknesses presented in this report should be taken into consideration by the Board of Directors to improve financial management and control in the District Heating.

3.1 Budget Planning and Execution

We have considered the sources of budgetary funds for the District Heating, spending of funds by economic categories, and collected revenues. This is highlighted in the following tables:

Table 1. Planned and incurred economic categories (in €)

No	Description	Initial Planning 2016	Reviewed Planning 2016	Outturn 2016	Outturn 2015
1	Revenues ⁶	740,000	700,000	1,047,819	173,111
2	Expenditures	(740,350)	(740,350)	(1,098,384)	(420,919)
3	Profit/Loss (1-2)	(350)	(40,350)	(50,565)	(247,808)

With the initial budget according to the business plan, the District Heating planned revenues from collection of old debts under the law and the collection of old debts by the court in the amount of €55,000 and with a revised final budget this changed to €51,000. Meanwhile, the table is presents the revenue plan that the District Heating expects to collect from its main activity.

During the year 2016, it did not manage to execute other revenues from grants or donations, mainly covering its activity from revenues from the sale and subsidies of the Government for purchasing raw material-heavy oil. Revenues in 2016 were in the amount of €1,047,819. They relate to revenues made from sale during this year in the amount of €298,026 and other revenues from subsidies and deferred revenues from donor grants in the amount of €749,793 according to the income statement.

Expenditures of 2016 compared with the previous year are much higher because during 2016 the District Heating provided heating. Its operation creates high water and electricity costs, while in 2015 the company provided heating only for 17 days due to the accounts blocked which occurred in that year and did not utilize government subsidy for 2015 because the money was in danger of confiscation.

Table 2. Spending of funds by economic categories - outturn against budget - (in €)

Description	Initial Budget	Final Budget	2016 Outturn	2015 Outturn
Spending by economic categories	740,350	740,350	1,098,384	420,919
Wages and Salaries	140,000	181,000	183,600	147,450
Goods and Services, including Utilities	100,350	159,350	169,628	29,480
Cost of Goods Sold	500,000	400,000	584,650	61,760
Depreciation			160,506	182,229

⁶ Revenues include: incomes from POE business, grants and loans (if any).

Explanations for changes in budget categories are given below:

- The initial budget compared with the final one indicated an upward trend due to the Board's decision to return the salaries earlier level. The Board's decision was applied for reinstatement since the previous year's salaries were reduced by 5% due to financial difficulties.
- For Goods and Services, the District Heating budgeted the utilities, maintenance, repair, other administrative expenses. Initial budget with the final one was increased due to the increase for: legal obligation from €5,000 to €50,000, other expenses from €5,000 to €8,000, electricity costs from €60,000 to €70,000 and finance software from €1,000 to €2,000.
- The initial and final budget was reduced from €500,000 to €400,000 for raw material – heavy oil as CGS, due to government decision. CGS relates to the expenditures of the raw material-heavy oil in the amount of €583,351 and the CGS of the Economiser in the amount of €1,298. Execution is higher in the budget as a consequence of stock transfer since 2015.

Issue 9 – Budget Execution – Medium Priority

Finding	The Enterprise had a final budget for wages and salaries in the amount of €181,000 while it executed €183,600 and final budget for goods and services was €159,350 and execution was €169,628. These changes were a result of inadequate budget planning.
Risk	Inadequate budget planning will result in a failure to meet organisational objectives and result in current year obligations being funded from future year budgets.
Recommendation 9	The Chairman of the Board should ensure that budget performance is systematically monitored on a monthly basis and that this review identifies and addresses barriers to planned levels of budget execution.

3.2 Revenues

From the activity of the Enterprise, revenues from sales amounted to €289,026, while €16,219 was generated in the previous year, due to better performance in 2016. Compared with the planned €300,000, revenues were generated of 99%.

Table 3 Planned and Executed Revenues (in €):

	Initial Budget 2016	Final Budget 2016	Outturn 2016	Outturn 2015
Revenues	740,000	700,000	1,047,819	173,111
Revenues from main business activity	240,000	300,000	298,026	16,219
Revenues from subsidies	500,000	400,000	749,793	158,892

District Heating, with an initial budget has also planned revenues from collecting old debts (according to the law on Debt forgiveness) in the amount of €50,000 and collection of old debts through the court of €5,000. Further on, the same planning was reflected in final budget but by reducing the planning for collection through the court for €1,000 (from €5,000 to € 1,000).

From this planning, the District Heating managed to generate revenues of €298,026 almost as planned by the heating activity.

The budget for Subsidies has changed with the government's decision, and the District Heating managed to receive a subsidy in the amount of €400,000 in 2016. The execution of €749,793 relates to the 2016 subsidy and the carrying forward value of the stock from the previous year's subsidy, which was not used because the Enterprise did not provide the service as a result of the accounts blocked and the difficult financial situation.

Recommendations

We have no recommendations in this area.

3.2.1 Revenues from the Enterprise business

Regular revenues generated in 2016 totalled €298,026. These relate to revenues generated by the heating service and new connections for private and public clients.

Issue 10 - Inadequate Management of Revenues - High Priority

Finding

While testing this category we have noticed the following shortcomings:

- Distribution of billing is done through cashier and payments are in most cases receiving by the collector not through the bank. The money is delivered to the cash box and at the end of each day they are delivered to the bank account of the District Heating because most of the private customers do not pay through the bank. There is a cash-in-check system, but accepting cash at hand always carries risks inherent in cash flow.
- Further on, we have noticed that the cash replenishment is not regulated by a policy that sets the limit or controls. In the cash register cash is kept for the needs of the company, which are spent according to the rules for petty cash, not exceeding the value of €100. However, money in the cash box is not deposited in the company's bank account but they are stopped directly from the revenue collected based on the needs of the company due to the procedures on depositing and withdrawal; and
- In one case in accounting, for the connection service, the District Heating incorrectly calculated VAT of 8% although the invoice for these services was correct at 18%. Here is also calculated a discount for connection that was not adjusted by any procedure.

Risk

Revenue circulation through cash may result in poor controls and misuse or error. Revenues may be subject to fraudulent manipulation or error.

Recommendation 10 The Chairman of the Board should ensure that appropriate revenue control systems are applied. With particular emphasis, consideration should be given to the drafting of the management procedure and the cash limits in the cash box.

3.2.2 Revenues from other sources (government grants)

The District Heating in 2016, presented €749,793 of other revenues. The value of €61,848 was from grants received for funds from previous years, where the proceeds received from the grants are presented separately from the amount of the loan received, which is presented as a deferred income in the liability column of balance sheet. Assets received are amortised and charged as an expense, while deferred revenue expends in the future over the useful life of the received asset.

Further on, the District Heating has also presented subsidies in the amount of €687,935 for purchasing heavy oil. This relates to government subsidies of €400,000 for 2016 and subsidies carried forward from the previous year.

Recommendations

We have no recommendations in this area.

3.2.3 Wages and Salaries

Wages and Salaries are paid through the bank account of the District Heating and are calculated from the District Heating Accounting Software. Key controls confirming the accuracy and completeness of payments are provided by the internal control system, reporting for: units, attendance, working hours, absents from work, meal, or work out of regular rate. The administration prepares a general salary report by referring to the unit report and the same is sent to finance. The District Heating has 32 officers including the board. Board members (4 non-executive) are paid according to the shareholder's decision and the other staff is paid the basic salary by adding the experience of 0.5% for each year of work and €2.5 for per diems.

Issue 11 – Shortcomings in salary management – High Priority

Finding

The management of salaries was followed by the shortcomings as below:

- The basic salary contracted for staff could not be verified in the absence of a regulation/statement on determination of payment and staffing categories. According to the Labour Law no. 03/L-212 (art. 55.4), the employer must issue a statement for each salary and any other paid contributions of the employees and by Law no. 03/L-87 on Publicly Owned Enterprises (Article 20.4) obliges the Audit Committee to prepare and publicly disclose a statement on the compensation policy for directors and officials of the Publicly Owned Enterprise.

- There was no evidence in staff file for staff performance appraisal. This does not comply with the requirements of the Law on Publicly Owned Enterprises (Article 28.1) requiring the Board of Directors to annually carry out a systematic performance appraisal. The Chairman is responsible for ensuring regular and timely performance appraisal. The appraisal will analyse the overall performance of the board as well as the effectiveness and contribution of individual board members. Similarly, the same Law (Article 34.3.a.b) obliges the enterprise to produce a policy on the titles, duties and competencies of each Enterprise officer and a policy on recruiting management as well as assessing effectiveness in accordance with standards of fairness and transparency. Further on, we were not able to determine that the assignments assigned to the staff, as agreed with the employer, were or were not satisfactorily met by the employee, how the performance at work is measured, or a description of this performance that could precede an improvement in the future or in the preparation of a plan for adequate training, promotion or reduction due to good or bad performance
- During 2016, the District Heating declared wage expenditures in the amount of € 183,600. In 2016, the District Heating had managed to pay back salaries from July 2014 until January 2016, respectively 19 salaries, from revenues collected in the amount of € 210,269. Also, as payables payable, the Enterprise has presented the amount of € 142,642 relating to unpaid salaries of employees during 2016 (February - December). Further, the District Heating was also obliged to TAK for not paying taxes, contributions, penalties and interest due to the financial difficulties of the Enterprise. The value of these liabilities from 2010 to 31.12.2016 was € 187,822 which remain to be paid in the coming years.

Risk

The identified shortcomings do not provide assurance on the actual determination of salaries. Also, the lack of an employee assessment reflects the impossibility of measuring performance and jeopardizes the proper performance of contracted obligations. Uncovered obligations hamper the company's normal activity in the future and the consequence of increased punishment and interest and may result in indictments for unpaid wages.

Recommendation 11 The Chairman of the Board should ensure transparency when remunerating officers in accordance with legal requirements and put in place instruments for measuring/appraising staff performance. Also, he should ensure that additional actions are being implemented to reduce the obligation for taxes, contributions, salaries payable, and employees execute the right to a regular salary for wages and salaries, the right of employees guaranteed by law on labour.

3.2.4 Goods and Services and Utilities

The Final Budget for Goods and Services in 2016 was € 159,350. The invoiced expenses of the period are presented in the statement of income in the amount of €169,628. They relate to expenses of bad debts, interest, electricity, water, audit, advertising, travel expenses, representation, office supply, telephone expenses and other expenses.

Issue 12 –Lack of reports for goods and services received - Medium Priority

Finding In three cases, the District Heating did not establish a Receiving Committee for the works under the contract. The purchase of a “Generator and Water Pump” was received through a storage order in the amount of €565, “Repairs to the Boiler building” were accepted through the process of executing the works in the amount of €973 and “Repair of the Pumps” in the amount €2,524 received through a process of executing the works by the department manager, rather than with an receiving report by a committee according to the rules. Furthermore, in the case of “Repair of Pumps”, the order for the execution of the works was done on 18.01.2016, while the invoicing was received prior to this report three days earlier because the controls were not properly in place.

Risk The receiving report does not provide assurance that the goods/services/works are accepted under the financial bid, contract specifications. Shortcomings identified result in inadequate controls.

Recommendation 12 The Chairman of the Board should ensure that adequate controls are in place for receiving goods, services or works. Acceptance must be made in accordance with the rules and the acceptance report should be a proof of the contract performance and the payment execution.

3.2.5 Capital Investments

The enterprise operates with inherited equipment and obtained from donations. During 2016, the District Heating has shown only one investment activity in the amount of €9,870, which is related to the obligation from the past paid through the court decision. In the previous year, the District Heating capital invested in the amount of €67,372.

Recommendations

We have no recommendations in this area.

3.3 Assets

3.3.1 Capital and Non Capital Assets

The net value of non-current assets owned by the Enterprise on 31 December 2013 was €1,594,815.

The structure and changes to these assets are given in the table below:

Table 4. Assets by categories and amounts (in €)

Description	Land	Building	Plant and Equipment	Total
Historic cost (Purchase value)	210,600	399,716	3,603,114	4,213,430
Accumulated Depreciation (up to 2015)	0	214,736	2,221,650	2,436,386
Purchases during the year	0	0	0	0
Revaluation of assets	0	0	0	0
Depreciation within the year	0	19,944	162,285	182,229
Net Book Value as of 31/12/2016	210,600	165,036	1,219,179	1,594,815

Issues 13 - Shortcomings in asset management - High Priority

Finding

Due to evidence from the past, the District Heating had shortcomings in identification and presentation of asset records as follows:

- An investment in 20MW boilers of €132,424 does not have a date of registration in the asset register
- A 4HP Jet printer in the amount of €165 does not have a date of registration in the asset register;
- Eight devices (stoves , closet, cash boxes, desk, broom) do not have the date of registration in the asset register;
- In 40 cases within other devices (circuit breakers, voltmeters, parts, valves, contactors, etc.) had no record date or registration value in the asset register.

- In 23 other equipment (valves, exchangers, pumps, transformers, aggregates, electricity meters, equipment for preparation of gasoline, etc.) in the amount of €476,190, the date of registration in the assets register is unknown.
- In addition to other equipment, two substations in the amount of € 7,793 do not have a date of registration in the asset register; and
- Further on, the standards required to be reassessed of assets, however, the District Heating did not reassess the assets as a result of the lack of experts in this area.

Risk Shortcomings identified reflect unfair and full presentation of depreciation and realistic position of assets.

Recommendation 13 The Chairman of the Board should implement a detailed control plan by providing additional mechanisms for identifying these errors in order to present full and accurate presentation of assets to the AFS.

3.3.2 Handling of Cash

The cash and cash equivalents include cash balances in bank accounts and in cash box. The District Heating at the beginning of 2016, according to the AFS, presented cash in the amount of €43,593 while at the end of the year, this amount was €4,949.

Collection of cash only from operating activities in the cash flow statement amounted to €754,410, compared with the previous year, the cash collected was higher for €83,114. Cash expenditures for operational activities alone amounted to €781,579 compared with last year, an increase of €222,238.

The cash spent from operating activities was €9,871 paid according to a court decision on the obligation from previous years. Compared with the previous year of €67,372, these expenses were reduced by €57,457.

The cash spent for financing activities was €1,605, compared with last year of €3,188, these costs were reduced by € 1,583.

Recommendations

We have no recommendations in this area.

3.3.3 Receivables

In the AFS, the District Heating presented the value of receivables from €1,598,011. This consists of trade receivables of 1,123,484 of the District Heating, which are sums of funds that customers owe to the enterprise for the services they benefited. Also, it consists of the other VAT receipts in the amount of €252,551, an advance of €13,879 that relates to a surplus payment for a client who withdrew the proceeds from a court decision, stocks in the amount of €203,148 relate to the stock of heavy oil €96,075 and the stock of goods (€107,073), as well as the current asset including cash of €4,949.

The District Heating presented the list according to the request of the law on debt forgiveness for the value of the receivables until 31.12.2008 of €1,086,030 and from 01.01.2009 to 31.12.2014 of €913,894. The District Heating entered into an agreement with customers, and €345,711 were owed debt until 31 December 2008, while payment arrangements amounted to €119,660, which are being paid under these agreements. Until 31.12.2016 the value transferred to be collected from these agreements is €66,130. Further on, during 2016, the District Heating sent nine (9) clients to the execution procedure for unpaid debt.

However, even against the activities undertaken by management, the value of the receivables remains high, the main debtors remains Municipality of Gjakova/shareholder for the obligation only for heating of schools in the amount of €229,567.

Issue 14 – Shortcomings in managing receivables - High Priority

Finding The District Company presented bad debts of €106,944 which decreased receivables. During 2016, the enterprise recognised bad debt costs of €43,000, because in the following year it is expected that some of the receivables to be reduced according to the law on debt forgiveness. Further on, the bad debt account has also been reduced from the previous year to the value of €300,611 as a result of debt forgiveness, reversing the value of €6,553 for non-compliance of the Agreement by the clients. The carried forward amount at the beginning of the year of €358,002 represents the value of bad debt from the past for which the enterprise does not have a policy in place of how this account is recognised.

Risk Accounting notes do not give a true reflection on receivables resulting in a non-sustainable reflection for financial reporting purposes.

Recommendation 14 The Chairman of the Board should ensure that the reconciliation of cash receipts records is made in order to present in a true and fair view in line with financial reporting standards. Further on, evaluate the producing an accounting policy based on the standards and rules in force for bad debts.

3.4 Capital and Liabilities

3.4.1 Capital

In Annual Financial Statements, the capital was presented in the following structure:

Description	On 31/12/2016	On 31/12/2015
Capital	1,571,709	1,655,499
Charter Capital	3,782,592	3,782,592
Reserve Capital	354,645	387,870
Profits/Losses carried forward	(2,514,963)	(2,267,155)
Profits/Losses of the current year	(50,565)	(247,808)
Reserve of revaluation	0	0

The District Heating is operating at a loss as a result of the fees Low and high cost of services which cannot be recovered from the realized revenues The loss is also due to the high value of the assets' devaluation owned by the enterprise However, despite this fact, the District Heating as a public enterprise established by Shareholder/The municipality expects large - scale subsidies and subsidies from the shareholder This company is indispensable for providing heat / thermal energy service.

3.4.2 Handling of Debts

The statement of short-term liabilities of €699,613 relates to trade payables of €216,006, taxes payable €258,356, payables to employee salaries €142,642, other liabilities - profit tax €78,736 and advance received from customers €3,872. These liabilities were carried forward to be paid in 2017. Compared with last year, which were €780,012, liabilities showed a downward trend. However, this reflects only a part of the budget constraint encountered by the District Heating and is discussed more thoroughly in subchapter 3.3.

Further on, the District Heating presented long-term liabilities against banks and deferred revenues of €921,506 related to liabilities from deferred revenue - amount of €123,176 and donations in the amount of €798,330.

The total value of liabilities presented in the Balance Sheet was €1,621,119.

Issue 15 - Shortcomings in managing liabilities - High Priority**Finding**

The total value of short-term liabilities presented in 2016 was €669,613. The high value of the obligation and the financial inability to settle these obligations represent the position of financial difficulty for the development of a normal business activity. In addition, the management of arrears was followed by the following shortcomings:

- The District Heating during this period shown an unpaid obligation in the amount of €216,006, the value of the liabilities remains high despite the fact that continuous efforts are being made to manage these obligations. Unpaid obligations are those for electricity, water, property tax and obligations to some economic operators for supply or completion of various works. These liabilities at the beginning of the year were presented as trade payable accounts of €245,884.
- The value of liabilities transferred to TAK as an obligation for VAT, withholding tax and contributions was €258,356 adding penalties and interest due to delays in performing obligations. The history of unpaid debts dates back from 2009 until now.
- The District Heating paid the obligation according to the court ruling no. 114/2013 for an operator according to a 2010 agreement in the amount of €9,870 for the “extension of the primary network of thermophysics - servicing/regulation of the SAACKE breiners” adding to the costs of the execution procedure, court proceedings, interest in the amount of €1,599. The payment was made after blocking the accounts dated 12.02.2016 for a 6 year obligation, as a result of the lack of financial means; and
- During this period the enterprise managed to pay salaries from July 2014 to January 2016, respectively 19 salaries. The liabilities carried forward from the previous year as short-term liabilities for payables of €195,988 were reduced and presented at the end of the year €142,642. However, despite the efforts to reduce these obligations, the District Heating did not yet been able to pay the salaries declared for 11 months of this period due to the financial situation.

Risk

The high value of liabilities and their seniority results in additional payments such as penalties, interest, and court expenses that increase the risk of court litigations.

Recommendation 15 The Chairman of the Board should ensure that necessary measures are taken to secure the budget, in order to reduce the arrears and liabilities of 2016.

3.4.3 Handling of Contingent Liabilities

According to the Standards, contingent liabilities are defined as an obligation resulted from of past events and the monetary value of the obligation cannot be measured with sufficient reliability. The District Heating disclosed contingent liability for two cases in court proceedings currently in the appeal proceedings.

Recommendations

We have no recommendations in this area.

Annex I: Audit Approach and Methodology

The responsibilities placed on the Auditor and Those Charged with Governance are detailed in the Opinion set out in Section 1.2 of this report.

While a key output of our work is the audit opinion this report reflects the totality of our work with specific focus also on Governance Issues including Financial Management and Control. The latter is informed by our extensive, risk based, compliance audit programme.

The Executive Summary is intended to highlight the key finding of the audit and the key action that the Chairman of the Board should ensure are taken to address identified management/control weaknesses.

The detailed report provides an extensive summary of our audit finding with emphasis on determining the cause audit findings and providing appropriate recommendations to address these. For completeness we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

High Priority - issues which if not addressed may result in a material weakness in internal control and where action will offer the potential for improvements to the efficiency and effectiveness of internal controls; and

Medium Priority - issues which may not result in a material weakness but where action will also offer the potential for significant improvements to the efficiency and effectiveness of internal controls.

Findings considered low priority were reported separately to finance staff.

Our procedures included a review of the internal controls and accounting systems and associated substantive testing and associated governance arrangements only to the extent considered necessary for the effective performance of the audit. Audit findings should not be regarded as representing a comprehensive statement of all the weaknesses which exist, or all improvements which could be made to the systems and procedures operated.

Annex II: Explanation of the different types of opinion applied by NAO

(extract from ISSAI 200)

Form of opinion

147. The auditor should express **an unmodified opinion** if it is concluded that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework.

If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with the section on "Determining the type of modification to the auditor's opinion".

148. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor should discuss the matter with the management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the audit opinion.

Modifications to the opinion in the auditor's report

151. The auditor should modify the opinion in the auditor's report if it is concluded that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or if the auditor was unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. Auditors may issue three types of modified opinions: a qualified opinion, an adverse opinion and a disclaimer of opinion.

Determining the type of modification to the auditor's opinion

152. The decision regarding which type of modified opinion is appropriate depends upon:

- The nature of the matter giving rise to the modification – that is, whether the financial statements are materially misstated or, in the event that it was impossible to obtain sufficient appropriate audit evidence, may be materially misstated; and
- The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

153. The auditor should express a **qualified opinion if**: (1) having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or (2) the auditor was unable to obtain sufficient appropriate audit evidence on which to base an opinion, but concludes that the effects on the financial statements of any undetected misstatements could be material but not pervasive.

154. The auditor should express an **adverse opinion if**, having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

155. The auditor should **disclaim an opinion if**, having been unable to obtain sufficient appropriate audit evidence on which to base the opinion, the auditor concludes that the effects on the financial statements of any undetected misstatements could be both material and pervasive. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the audit scope that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 1705¹⁹ provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

Emphasis of Matter paragraphs and Other Matters paragraphs in the auditor's report

157. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, but there is sufficient appropriate evidence that the matter is not materially misstated in the financial statements, the auditor should include an Emphasis of Matter paragraph in the auditor's report. Emphasis of Matter paragraphs should only refer to information presented or disclosed in the financial statements.

158. An Emphasis of Matter paragraph should:

- be included immediately after the opinion;
- use the Heading “Emphasis of Matter” or another appropriate heading;
- include a clear reference to the matter being emphasised and indicate where the relevant disclosures that fully describe the matter can be found in the financial statements; and
- indicate that the auditor’s opinion is not modified in respect of the matter emphasised.

159. If the auditor considers it necessary to communicate a matter, other than those that are presented or disclosed in the financial statements, which, in the auditor’s judgement, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report, and provided this is not prohibited by law or regulation, this should be done in a paragraph with the heading “Other Matter,” or another appropriate heading. This paragraph should appear immediately after the opinion and any Emphasis of Matter paragraph.

Annex III: Prior Year Recommendations

Audit Component	Recommendation given	Implemented	Under implementation	Not implemented
1. Valuation of Assets	<p>As disclosed in Note 7 to the underlying financial statements, the balance of cash on 31 December 2015 was €1,196,539, the amount which relates to the debts of customers from previous years. We were unable, by applying standard and alternative audit procedures, to determine if the company is able to collect the value of the receivables presented.</p> <p>We recommend that the enterprise management makes detailed analyses on uncollected cash receipts and this evidence that substantial efforts are made to collect the debt in order to make real estimates of collectable receivables and provision of bad debts.</p>		<p>In process of implementation, the enterprise has entered into an agreement under the law on debt forgiveness with several clients for debt forgiveness until 2008 and the payment agreement between 2008 and 2014 also in this year had taken additional steps for sending several cases to the bailiff.</p>	
2. Other Requirements	<p>As disclosed in Note 8, the Enterprise within Current Assets in presented receivables in the amount of €246,081 relating to VAT requirements against TAK. There is no such situation in the monthly VAT returns for 2015. This requirement does not match the situation of TAK.</p> <p>We recommend that the necessary reconciliations are made between the items in financial statements related to the tax and the situation in TAK so that there are no differences and shortcomings between the items of the financial statements and the TAK situation of those items.</p>	<p>It has been implemented, the enterprise has been subject to a check by TAK, until the 11th of month the inspector has made the required corrections for VAT. While in 12th of month, this situation is consistent between the VAT statement and the VAT requirements presented in the AFS.</p>		

3. Cost of goods sold	<p>As disclosed in note 14, the cost of goods sold to the income statement of €61,760 differs from that in the CD⁷ report for TAK €74,622 for €12,861, of which the financial result of the enterprise was influenced.</p> <p>We recommend that the reconciliations between the CGS are presented in the income statement and the CGS presented in the CD report for TAK.</p>		Differences are evident, because reporting on CD is prepared according to TAK requirements/ policies.	
4.Cash	<p>We have noticed that the cash balance on 15.11.2015 was in the amount of €1,663. We consider that this amount of cash held in the cash box is unnecessary for the company's daily needs.</p> <p>We recommend that the management makes a decision on the maximum cash in the cash box so that the cash is deposited at the bank at the end of the working hours.</p>		So far, the enterprise has drafted a rule and procedure for the budgeting and control process, where the cash limit is foreseen, but the same is expected to be approved by the board of directors.	

⁷ CD - is a designation for the Annual Statement Form and Corporate Income Taxes".