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AUDIT REPORT

ON THE ANNUAL FINANCIAL REPORT OF THE PUBLICLY OWNED ENTERPRISE KOSOVO RAILWAYS – TRAINKOS- JSC FOR

THE YEAR ENDED 31 DECEMBER 2016

Prishtina, May 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 Kosovo Railways – Trainkos- JSC* in consultation with the Acting Assistant Auditor General, *Vlora Mehmeti,* who supervised the audit.

The opinion and report issued are a result of the audit carried out by *(Ganimete Dalloshi (Team Leader) and Valmira Jonuzi* under the management of the Head of Audit Department Enver Boqolli.

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Executive Summary

Introduction

This report summarises the key s arising from our audit of the 2016 Annual Financial Report of the Kosovo Railways – Trainkos- JSC (hereinafter: Trainkos), 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 Plan[1] 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 Trainkos.

Opinion of the Auditor General

<u>Adverse Opinion</u>

The Annual Financial Statements do not *present a true and fair view* in all material aspects.

Other issues

The Annual Financial Statements of Trainkos for the year ended on 31st of December 2015 were 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 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

The Financial Statements contain material misstatements spread out in the financial statements. These have resulted in an adverse opinion on AFS.	The Chairman of the Board should analyse the reasons for the 2016 Adverse Opinion and undertake actions required to enable a true and fair presentation for AFS in 2017.
Most of the prior year's recommendations remain unimplemented.	The Chairman of the Board should implement a rigorous oversight process to ensure the implementation of prior year recommendations (see issue 3)
Failure to set timeframes in order to meet business and financial goals	The Chairman of the Board should ensure that, in addition of defining the business and financial objectives, he should also sets the timeframe limits for their execution (see issue 4).
There are a number of weaknesses related to the functioning of the Internal Audit Office	The Chairman of the Board should ensure that the Audit Committee reviews the implementation of the plan, the outcome and the quality of the audit reports as well as the actions taken by the management in relation to internal audit recommendations (see issue 6)
Regarding financial management and control, many weaknesses have been identified in all areas.	The Chairman of the Board should take action in order to eliminate the weaknesses in the FMC area (see issues 7-20)

Response of the Chairman of the Board – audit 2016

The Chairman of the Board has taken into consideration and agreed on detailed audit findings and conclusions and committed to address the recommendations given.

1 Annual Financial Statements and other External Reporting Obligations

1.1 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.

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 with the assurance that all relevant information has been provided to ensure that a comprehensive audit can be undertaken.

1.2 Audit Opinion

Adverse Opinion

We have audited the AFS of the Trainkos for the year ended on 31st of December 2016 which include the Statement of Financial Position, Income Statement, Cash flow Statement, statement of the Changes in Equity and the Explanatory Notes.

In our opinion, due to the effects of the described in the Basis for Adverse Opinion paragraph, the Annual Financial Statements do not present a true and fair view in all material respects 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 Adverse Opinion

We have created the basis for adverse opinion for the reasons mentioned below:

- Under IAS, a suspense account is a temporary account and under no circumstances should a suspense account be available at the time the statement of financial position is prepared. In the accounting records, there is an amount of €340,000 on the loan side with the description "off-balance sheet liabilities". However, in the analytical chart there are no clear descriptions to understand the content of this amount, the only description is the adjustment by equation.
- The value of the reserve capital presented in the AFS was understated by €269,668 as a result of the discrepancy between the accounting records and the financial statements.
- other payables in the amount of €227,196 were presented within long-term liabilities. However, this amount of funds during 2016 was collected by the other party through

executing procedures. Further on, we could not identify that during the registration of this amount, which balance is debited. Such a biased registration has caused an unfair presentation of the financial statements.

- Accounts receivable presented in the Annual Financial Statements were understated by €124,314 as a result of the discrepancy between the accounting records and the AFS. Further on, the company failed to send nine letters of confirmation in the amount of €278,869, with the reasoning that they do not have client addresses and do not have any evidence (invoice, contract) proving that the amount registered as a receivable belongs to the client, while these clients exist in the accounting records. In the letter of confirmation we received from a Trainkos client, the amount of the debt is €67,839, while in the Company's accounting records is €44,047, with an understatement of €23,791. This was as a result of not reconciling accounting records with clients.
- The value of stocks presented in the AFS was understated by €40,944 compared with the accounting records. During the physical counting of stocks by the committee for physical registration, the value of stocks was for €73,550 bigger than the value in the accounting records. This difference was not recorded in the accounting records, which leads to the understatement of the stocks.
- Explanatory notes do not provide complete and accurate disclosures for all items presented in the financial statements, for more details see subchapter 3.7.
- Non-revaluation of non-current assets. Under IAS 36 at least once in three to five years, an asset revaluation should be made. Trainkos did not make the asset revaluation since the establishment. This has happened due to lack of knowledge on the relevant standard.
- Assets (computer, laptop, furniture, etc.) were not recorded in the non-current assets register which meet the recognition criteria under IAS 16. The value of these assets cannot be measured. This affects the incorrect presentation of the value of non-current assets.
- In addition to the errors presented above, we have identified other non-material errors in recording and presentation of payables, equity, and assets in the AFS.

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 Trainkos in accordance with the ethical requirements that are relevant to our audit of the annual financial statements of Budget Organisations 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 adverse opinion.

Other issues

The Annual Financial Statements of Trainkos for the year ended on 31st of December 2015 were audited by another auditor who, on 29th of April 2016, issued a qualified opinion on these statements because: the opened accounts for fixed assets were not handled in the base documentation since they were common for both "Trainkos" and "Infrakos"; the enterprise was not audited by tax authorities on fiscal matters for 2015; there was a difference of €11,902 between the inventory-stock value in the financial statement and the report of the Stock Registration Commission; the receivables and payables balances were not supported with confirmations by the buyers and suppliers respectively; the enterprise operates with financial losses which it covers with subsidies and support from the Government of Kosovo.

Responsibility of the Management and Those Charged with Governance and AFS

The Chairman of the Board within Trainkos is responsible for the preparation and fair presentation of financial statements in accordance with International Accounting Standards (IAS), International Financial Reporting Standards (IFRSs) and Kosovo Laws. Financial statements have been prepared based on accrual accounting principle. It is also responsible 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 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).

The Chairman of the Board is responsible to ensure oversight the 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. Our objective is to obtain reasonable assurance that an audit conducted in accordance with ISSAIs will 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.

1.3 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 Law no. 02/L-123 on Business Organisations;
- Requirements of Law no. 04/L-087 on Publicly Owned Enterprises (as amended and supplemented);
- Requirements of Law No. 04/L-014 on Accounting, Financial Reporting and Audit;
- Requirements of the Law on Public Procurement (as amended and supplemented);
- Requirements of Administrative Instruction no. 2/2013/MoF on Structure and Content of Annual Financial Reports;
- POEs are also required to prepare the following reports:
    - Charter of the POE;
    - Business Plan;
    - Quarterly reports;
    - Annual reports;
    - Customer Satisfaction Report; and
    - Draft plan and final procurement plan in time.

Issue 1 – Preparation of Annual Financial Statements – High Priority

In our Interim Audit Memo, dated 14/12/2016, we have raised some issues regarding the financial statements that may have an impact on the opinion. Issues raised were not 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 which contained material errors. Despite our suggestions, we have identified the findings that we have presented to the basis for the opinion.

Given the above - The Annual Financial Statements prepared by the Chief Executive Officer and the Chief Financial Officer when AFS are submitted to the Board of Directors cannot be considered accurate because material errors have been identified.

1.4 Recommendations for the first part of the report

We have no recommendations related to the AFS

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 the Adverse Opinion. Actions should be taken to address the underlying causes in a systematic and pragmatic manner to remove errors in the Annual Financial Statements and to ensure a fair and true view.

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 related issues. This should include Management review of the draft AFS with specific focus on high risk areas and/or areas where errors have been identified in previous years. AFS should be approved if all necessary checks have been applied to the draft AFS.

2 Governance

2.1 Introduction

Effective governance arrangements are fundamental to Trainkos 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.

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, segregation of duties, fulfilment of customer requirements (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)

2.2 Overall Governance Conclusion

There are gaps in existing governance arrangements within Trainkos such as: failure to implement prior year's recommendations, failure to set timeframes on business and financial goals in the business plan, internal audit system is not fully effective in strengthening internal controls. These areas need to be reviewed and concrete actions to be undertaken to address them.

The implementation of prior year's audit recommendations as a key tool to support effective governance has not been taken into account by Trainkos management. This is an indication that Trainkos did not strive to develop existing processes and strengthen controls in many areas.

Trainkos approved the business plan for 2016, but it does not include timeframes for meeting business and financial goals. The lack of timeframe for meeting business and financial goals makes it impossible to follow their fulfilment in terms of time, when these goals should be met.

Further on, the internal audit system as a key element of the internal control system failed to support management in relation to the assessment of internal controls in the enterprise. Failure to identify financial errors in the audit of the financial statements for 2015 resulted in these errors being carried forward to the 2016 financial statements. However, even when recommendations from the internal audit were given, no management action has been taken to address these issues.

2.3 Progress in the Implementation of Prior Year Recommendations

External Audit Report[2] on the 2015 AFS of Trainkos resulted in six (6) key recommendations. Trainkos prepared an Action Plan stating how all recommendations will be implemented. By the end of our 2016 audit, only one (1) recommendation has been implemented. For a more thorough description of the recommendations and how they are addressed, see Annex III.

Issue 3 – Implementation of Prior Year Recommendations – High Priority

Finding	From total of six (6) prior year recommendations, only one (1) was fully implemented. This occurred because Trainkos Management has not followed any formal process to manage and monitor the way that the External Auditor's recommendations are or are not implemented.
Risk	Failure to implement recommendations increases the risk of continued presence of the same shortcomings related to financial statements as well as financial management and control in general.
Recommendation 3	The Chairman of the Board should ensure that a action plan is implemented which clearly sets out a timetable for implementing the recommendations made by the External Auditor with accountable staff members identified and with initial focus on those of greatest significance. The reasons for not addressing prior year recommendations should be analysed with the relevant directors and reported to the Chief Executive Officer.

2.4 Specific Governance Reviews

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

2.4.1 Setting of Strategic Objectives

Legal framework requires from Publicly Owned Enterprises to draft Business Plan, which should be approved by the Board of Directors within the legal timeframe.

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[2] External audit report - Audit of Trainkos AFS for 2015 was carried out by a private audit firm, not by the NAO, and their reporting included a report with the opinion and a letter to the management where the findings and recommendations were presented.

Issue 4 – Failure to set timeframes for executing business and financial goals - High Priority

Risk The Board drafted and approved the business plan for 2016 within the legal deadline. The plan contains the business and financial goals the Company intends to achieve during 2016 and the approach to achieve these goals. However, the plan does not include deadlines for executing these goals.

Risk Lack of timeframes for achieving goals makes it impossible to follow their fulfilment in terms of the time when these goals should be achieved.

Recommendation 4 The Chairman of the Board should ensure that the business plan, in addition to business goals and approach to their implementation, contains the timeframes for their execution as well.

2.4.2 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 5 – Weaknesses in Management Controls – High Priority

Finding Our review of the management controls applied to Trainkos' key financial system highlighted that accountability and communication lines were in place through regular meetings and written reporting. However, in many areas, internal controls have not been applied effectively and failed to prevent mistakes during the year. With particular emphasis, the controls were ineffective when it comes to implementing prior year's audit recommendations, management of receivables, payables, non-current assets, inventories, revenue execution, expenditure execution, human resource management, execution of payments without certification, inadequate categorisation of expenditures and delays in executing payments.

Risk Failure to apply controls effectively reduced the effectiveness of financial management within Trainkos. This can also result in inaccurate financial data.

Recommendation 5 The Chairman of the Board should consider the reasons for not applying the controls effectively in the areas mentioned above and ensure their elimination in order to improve these weaknesses.

2.5 Internal Audit System

The Internal Audit Office (IAO) operates with two staff members - the Director of IAO and one auditor. IAO prepared the strategic and annual plan. The annual plan had foreseen seven (7) audits and carried out seven (7), but five (5) were completed and two (2) were replaced with two (2) other upon request by the Management. An effective audit requires a comprehensive work programme that reflects financial and other risks to Trainkos and provides sufficient assurance over the effectiveness of internal control. The impact of Internal Audit output should be judged by the importance that management places on addressing recommendations and the support and challenge provided by an effective Audit Committee. The three-member Audit Committee held regular monthly meetings where they discussed the internal audit plans and outcomes as well as the external audit report.

Issue 6 - Shortcomings in functioning of IAO - High Priority

Finding	There are weaknesses related to the current IAO operations as follows: • The Internal Audit related to the financial reports for 2015 did not identify any of the weaknesses identified by our audit regarding the initial balances of the 2016 financial statements; and • Trainkos Management did not prepare a plan for implementing IAO recommendations and as a consequence there were setbacks in their implementation.
Risk	The internal audit report which does not reflect the entity's existing risks affects the failure to identify and address weaknesses in controls resulting in inaccurate, ineffective and operational losses. Further on, failure to prepare the action plan confirms the non-willingness of the management to improve the existing processes.
Recommendation 6	To gain maximum benefit from Internal Audit activity, the Chairman of the Board should ensure that an Audit Committee critically reviews Internal Audit plans, execution of the plan, outcome and the quality of audit report. It should also review actions taken by management on Internal Audit recommendations.

3 Financial Management and Control

3.1 Introduction

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

3.2 Financial Management and Control Conclusion

Controls on the overall management of Trainkos 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 which may lead the enterprise to failure to meet the objectives and the inability to cover the costs. During 2016, the enterprise operated with a loss of €1,186,710. In this financial outcome, as well as in the activity of the enterprise as a whole, significant impacts came from the collection of planned revenue from transport of goods, not fully covering passenger transport losses for the lines approved by the Ministry of Infrastructure for 2016 as well as the condition of outdated vehicles.

Given these current state of affairs, without a real basis to find an adequate solution in overcoming it and in increasing the activity sends into a situation where the continuity of the enterprise is at stake.

Further on, other processes such as employee recruitment were not managed in compliance with legal requirements. Employees' engagement for work and specific tasks for regular job positions and without developing any competitive process, unequal treatment of candidates during the interview and failure to notify applicants in writing minimizes competition and increases the risk of engaging people proper in certain positions.

Execution of unpublished expense payments, double VAT application, and non-assignment of contract managers are indicative that internal controls in payment processing and procurement management need improvement. Further on, existing assets management processes need to be reviewed with special emphasis on drafting a regulation on asset management and asset handling in accounting records.

These and other weaknesses presented in this report should be considered by the Board of Directors to improve financial management and control in Trainkos.

3.3 Budget Planning and Execution

We have considered the sources of budgetary funds for Trainkos, spending of funds by economic categories. This is highlighted in the following tables:

Table1.Economic categories planned and executed

No	Description	Initial planning 2016	Revised planning	2016 Outturn	2015 Outturn	2013 Outturn
1	Revenues	**5,108,272**	**4,557,889**	**3,151,291**	**5,096,606**	**5,108,272**
2	Expenditures	5,090,395	4,489,517	4,338,002	4,996,780	5,090,395
3	Loss/Profit (1-2)	17,877	68,327	(1,186,711)	99,826	17,877

Revenues presented above include revenues from enterprise business activity, revenues from subsidies received from Ministry of Infrastructure, Ministry of Economic Development, and revenues from other grants.

When it comes to expenditures, the value presented in the table above represents all expenses incurred during the year including depreciation expenses.

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

Description	Initial Budget	Final Budget	2016 Outturn	2015 Outturn
Spending of funds by economic categories	**5,090,395**	**4,489,517**	**4,338,000**	**5,969,073**
Wages and Salaries	1,723,706	1,807,500	1,769,155	1,773,449
Goods and Services	1,491,689	1,189,867	245,393	1,294,269
Service Cost	1,875,000	1,492,150	1,338,142	1,929,064
Depreciation Expenditures	0	0	985,310	972,291

Capital Investment Category is not presented in the table above, because capital investments that have been completed during the year, their cost is recognised through depreciation expense. The amount of investment received during the year is presented within assets as a purchase during the year.

Explanations about changes in budget categories are provided as follows:

- The increase in budget for Wages and Salaries for €83,794 is the result of the increase in new recruitments that occurred during 2016.
- The expenditure for budget of the Goods and Services category in relation to the planning was 20%. This low execution occurred as a result of the poor financial situation.

- Utilities were also planned within the service cost. Budget execution in relation to planning for this category was 90%.

Issue 7 – Improper categorisation of expenditures – High Priority

Finding	According to IAS 2, service costs consist mainly of labour costs and other personnel costs directly engaged in service delivery. While other costs are recognised as expenses in the period in which those services are incurred. In the service cost were included all municipal expenditures related to electricity, waste, water and heating expenditures in the amount of €44,022, and as such they should have been categorised as expenditures of the period.
Risk	Incorporating utility costs into service costs creates inaccuracies in the items of financial statements.
Recommendation 7	The Chairman of the Board of Directors should ensure that only costs incurred regarding the servicing cost are included within the service cost, while other expenses are recognised as expense of the period.

3.4 Revenues

Trainkos for 2016 planned to collect revenues in the amount of €4,577,889, while it collected €3,151,291. Trainkos generates revenues from its activity as well as other sources which are presented in the following table.

Table 3. Planned and collected revenues in €:

	Initial Budget 2016	Final budget 2016	Outturn 2016	Outturn 2015
Revenues:	**4,016,272**	**4,577,889**	**3,151,291**	**4,351,131**
Revenue from transport of goods	2,052,764	897,315	589,146[3]	1,734,612
Revenues from passenger transport	208,165	208,165	188,906	195,050
Other revenues	323,525	155,117	173,670	232,450
Subsidy revenues - Ministry of Infrastructure	931,959	1,967,292	759,766	789,427
Revenues from subsidies - Ministry of Economic Development	500,000	500,000	499,999	500,000
Revenues from capital investment grants[4]			939,804	899,592

[3] The amount in transport of goods includes the amount of collections and deductions received in the amount of €6,260

[4] Under IAS 20, grants received for depreciable assets are recognised as income over the periods in which depreciation for those assets is charged. This means that in the amount for large capital shown in the AFS, revenues are recognised by recognizing as income part of the deferred grants of previous years for the amount of depreciation for those capital investments.

Issue 8 – Planning of Revenues – High Priority

Finding	Trainkos from transport of goods collected only €589,146 compared with the revised budget for this type of revenues, only 66% were collected. Compared with last year, the company faced a 66% decrease in revenues. This ocurred due to temporary interruption of transport by the main customer. However, this was not reflected in the revised revenue and expenditure plan to ensure proper enterprise management.
Risk	Poor planning processes, not taking into account the causes that can occur during the year, risks that the company does not reach the objectives and cannot cover its costs by increasing its obligations to suppliers.
Recommendation 8	The Chairman of the Board should ensure that revenues are monitored systematically and any changes or deviations from the initial plans are reflected in the revenue plan.

3.4.1 Revenues from POE business activity

Revenues generated by Trainkos from its business activity in 2016 amounted to €951,722. They relate to revenues from transport of goods, passenger transport and other services.

Issue 9 – Shortcomings in revenue management - Medium Priority

Finding	According to the contract for the transport of goods between Trainkos and the Client, in the event of a delay in paying the invoice, from the date of receipt within a period of 20 days, a penalty of 0.05% interest on the total debt per day will be imposed. In three cases no penalties were applied in the case of late payment of the invoice by the client. This is because the enterprise does not keep any records to identify unpaid and paid invoices. Further on, this occurred because Trainkos did not record revenues on timely basis.
Risk	Incomplete recording of invoices and failure to record the payment of each invoice causes difficulties in identifying the invoices on which the penalties should be applied. Failure to apply penalties affects in slowing-down the collection of revenues and the increase of receivables.
Recommendation 9	The Chairman of the Board should take measures to ensure that revenue records are made on timely basis, maintaining a register of paid and unpaid invoices from clients and apply penalties in case clients have delays in payments.

3.4.2 Revenues from other sources

Revenues generated from Subsidies and Grants in 2016 were €2,059,765. Out of which €759,766 have been received from the Ministry of Infrastructure to cover the costs of passenger transport according to the Law on Kosovo Railways and in accordance with the EU Directives regarding the provision of services of general interest. In addition, €499,999 are revenues received from MED for the partial coverage of passenger transport losses. During this period, Trainkos had also received 800,000 euros for capital investments allocated by MED.

Recommendations

We have no recommendations in this area.

3.4.3 Wages and Salaries

Wages and Salaries are paid through the Enterprise bank account and are calculated by the Trainkos accounting software. Key controls confirming the accuracy and completeness of payroll payments are provided by the internal control system.

The current number of employees at the end of the year was 237 employees and 6 members of the Board of Directors. We have tested some recruitment procedures, personnel files, and we have reviewed the payrolls and compared the data from the accounting records and their presentation to the AFS.

Issue 10 – Human Resource Management - High Priority

Finding	While the testing of this category we have noticed the following shortcomings: According to the Labour Law (Article 8), the Public Sector Employer is obliged to announce public vacancy whenever an employee accepts and establishes an employment relationship. During 2016, the enterprise had engaged 15 employees for specific jobs and duties, but these employees covered regular job positions and for which recruitment procedures were not developed. Unequal treatment of applicants during the recruitment process. According to the Labour Law (Article 5) discrimination is prohibited in employment and occupation, with regard to recruitment in employment. During the recruitment process for the position of Marketing Agent, the candidates who underwent the interview were not treated equally. This is because interview questions were not previously approved and unified for all candidates, instead the Committee applied completely different questions to each candidate. Weaknesses in the recruitment process. According to the Guidelines on Employment Relations (Article 5), the selected candidates must be invited in writing at least 48 hours before the test. In three recruitment processes, the applicants were not invited to the test in writing, and some of the applicants, despite having met all the criteria for attending the test, did not attend the test. According to the Human Resources Officer, all applicants were invited by phone.
Risk	Engaging Employee for jobs and specific tasks for regular job positions and without developing any competitive process, unequal treatment of candidates during the interview and failure to notify applicants in writing minimises competition and increases the risk of engaging inadequate persons at certain positions.
Recommendation 10	The Chairman of the Board should review the identified shortcomings and take the necessary measures to comply with the relevant legal provisions when engaging new staff, as well as positions with operational responsibilities should be exercised by officials/employees with regular employment contracts.

3.4.4 Goods and Services

The final budget for Goods and Services in 2016 was €1,189,867. Out of them, €245,393 were spent. They relate to operating and administrative expenditures of the enterprise.

Issue 11 – Non-Certification of the expenditure by the Certifying Officer - High Priority

Finding According to accrual[5] accounting principle, expenditures are recorded at the moment they occur and not at the time of payment. When recording the expenditures, they must be certified by the Certifying Officer. We have noticed 23 cases where Certifying Officer did not certify the cases. This is due to the lack of control by his part.

Risk Execution of non-certified expenditure increases the risk of making payments that do not comply with the relevant evidence and their amounts are not accurate.

Recommendation 11 The Chairman of the Board should ensure that controls are enhanced so that all expenditures are verified and approved by the Certifying Officer prior to recording them in the accounting system.

Issue 12 - Prices of Services in contradiction with Contract Terms - Medium Priority

Finding the agreement between Trainkos and Kosovo Railways Infrakos JSC, for internet and radio services, specifies that the fixed amount for services provided in the agreement means the amounts including all applicable tax obligations in the country.

However, in invoices received for internet and radio services, in 21 cases, VAT was calculated twice. This was due to a lack of control by the Certifying Officer.

Risk Failure to function with the internal control system when recording the invoices increases the risk of making payments with greater value than foreseen by agreement.

Recommendation 12 The Chairman of the Board should ensure that the Certifying Officer verifies the expenditures under the contract and for the part paid more to request return it to the enterprise's budget.

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

Issue 13 - Failure to Appoint a Contract Manager under the Law on Public Procurement - High Priority

Finding	According to the Law on Public Procurement, the Contracting Authority must appoint a contract manager immediately after the contract is signed. In one case, Trainkos did not appoint the contract manager, in which case the contract management plan was not drafted either. This was due to the lack of a decision by the Chief Executive Officer.
Risk	The non-appointment of the contract manager risks that the Economic Operator does not fulfil its performance obligations under the terms of the contract, payments are not made under the terms of the contract and not have quality control in place.
Recommendation 13	The Chairman of the Board should ensure appropriate measures to adhere to public procurement rules and exercise adequate oversight for management.

3.4.5 Capital Investments

The final budget for Capital Investments was €800,000. These are the funds MED allocated for capital investments. Out of these, in 2016 €722,672 were executed. They relate to the Locomotive Repair Project – Re-Fabrication and other capital projects under way.

Recommendation

We have no recommendations in this area.

3.5 Assets

3.5.1 Capital and Non Capital Assets

The value of non-current assets at the end of 2016 is €5,908,644. Maintaining the asset register in Trainkos is done with accounting software. Only assets of over €1,000 have been registered in the assets register.

Our audit included the assets purchased during 2016 to verify whether they were recorded in the accounting register and asset register.

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)	229,680	1,218,659	8,278,096	9,726,435
Purchases during the year		7,868	1,085,130[6]	1,092,998
Accumulated Depreciation	-	(248,764)	(3,657,940)	(3,906,704)
Revaluation of assets	-	(61,293)	(924,017)	(985,310)
Depreciation within the year				
Net Book Value as of 31/12/2016[7]	229,680	916,470	4,781,269	5,927,419

6 This project was contracted out in 2015, while it has been completed and recognised as a property in 2016. Payments for this Asset were made as follows: €752,948 was paid in 2015, while €256,660 was paid in 2016 and the remaining debt is €75,552.

7 These amounts are according to the accounting records, while in the AFS are understated by €10,132 for equipment and machinery, and buildings for €8,642

Issue 14 - Inappropriate non-current assets management - High priority

Finding

When the testing of non-current assets we noticed the following shortcomings:

- Discrepancies between accounting records and AFS. The value of non-current assets presented in the AFS was €5,908,644 whereas in the accounting notes this amount was €5,927,419, resulting in understatement of these assets in the amount of €18,774.
- Lack of Regulation on non-current assets management. According to the Company's Charter (Article 7), the Company must produce regulations containing provisions for the administration and operation of the joint stock company. Trainkos did not have any asset management regulations which is tailored to the needs and requirements of the company based on the standards and rules in force. This resulted from failure to assess the importance of the asset management regulation.
- Improper presentation of value for the facility. Costs of project design for renovation of the facility in the amount of €7,868 were capitalised as assets revaluation although this renovation was not carried out. This was a result of not knowing the IAS by the financial officer and the lack of an asset officer at the time of registration.

Risk

Understatement of assets, the lack of a regulation on asset management, and the increase in the value of assets in contradiction with IAS risks that assets are not properly handled and consequently affect the incorrect presentation of assets in the AFS.

Recommendation 14

The Chairman of the Board should produce an internal regulation defining the standard procedures for the management of non-current assets and ensure that assets are handled under the IAS and the applicable rules, presenting their fair value in the AFS.

3.5.2 Handling of Cash

Cash and cash equivalents include cash balances in bank accounts and cash registers. At the beginning of the reporting period, the cash position was €1,826,035, while at the end of the period this amount was €51,046.

Issue 15 - Expenses for official travel in contradiction with Regulation - Medium Priority

Finding	According to the Regulation on Official Travel (Article 4), all employees are required to make a request for an official travel attached, together with the official invitation to the institution and the agenda of the official meeting. In three cases in the amount of €5,783, requests for official travel were not supported by relevant evidence, such as official agendas or invitations.
Risk	Expenditures for official travel without relevant evidence risks that these funds are not used for official purposes, creating cash expenditures without legal grounds.
Recommendation 15	The Chairman of the Board should ensure that the requirements for financing official travel are assessed in accordance with applicable regulations and financed only when the appropriate criteria are met.

3.5.3 Receivables

Trainkos receivables represent the amount of assets that clients owe to the enterprise for the services they have benefited from the enterprise[8]. Trainkos presented receivables in the amount of €1,807,575, out of which €107,975 are part of subsidies from the Ministry of Infrastructure. Receivables this year show an increasing trend compared with last year for €406,935. This is due to the ineffective policies implemented by management and the lack of a strategy for collecting these debts. Deficiencies in the management and presentation of receivables are presented in the Audit Opinion subchapter.

3.6 Capital and Liabilities

3.6.1 Capital

In the Annual Financial Statements, capital is presented under this structure:

Description	**31/12/2016**	**31/12/2015**
Charter Capital	25,000€	25,000€
Reserve capital	4,733,550€	5,258,292€
Profit/Losses carried forward	560,051€	461,225€
Current Year Profits/Loss	(1,186,710)€	99,826.80€
Revaluation reserve	-	-

[8] During the audit period, the Minister of Infrastructure transferred these assets to the Trainkos bank account.

The notes presented in this table are according to the amounts presented in the AFS which are not the same as the notes in the accounting records.

Issue 16 - Failure to present accurate Equity - High Priority

Finding When testing the equity we have noticed the following shortcomings:

- Reserve capital consists of the value of assets invested by the shareholder of the enterprise. The initial value of the reserve capital at the date the company is founded in 2011 was €4,978,578. Whereas, at the end of 2016, the balance of this account is €5,003,218. This increase of €15,640 occurred as a result of the recording of stock differences which resulted in the recording at the end of the year by the inventory committee; and

- The value of retained earnings/losses that should have been presented in the AFS 2016 was €561,051, but this amount was understated by €1,000. This occurred due to a lack of accurate calculation by the financial officer.

Risk The recording of stocks in the capital reserve category as well as the understatement of the transferred profit/losses risks the company to overstate/understate any other remaining balance in order to balance the credit side with the debt side.

Recommendation 16 The Chairman of the Board should ensure that the necessary adjustments are made by setting up a review mechanism to confirm the accuracy of the amounts recorded in the accounting and the same are presented in AFS.

Issue 17 - Operations of an Enterprise with loss - High Priority

Finding	During the reporting period, the enterprise operated with a loss of €1,186,710. In this financial outcome, as well as in the activity of the enterprise as a whole, significant impacts had several reasons, the most important being: transport of goods as the most important activity of the company this year had a continuous decline, failure to fully cover loss from passenger transport for lines approved by the Ministry of Infrastructure for 2016, and the condition of outdated vehicles.
Risk	Given the above handlings, the current state of affairs, without a realistic basis for finding an adequate solution in overcoming it and increasing activities, leads to a situation where the continuity of the enterprise is at stake.
Recommendation 17	The Chairman of the Board and Chief Executive Officer should draft a strategic plan for sustainability and business improvement that should be mandatory in practice.

3.6.2 Handling of Liabilities

The statement of liabilities at the end of 2016 was €5,055,698. Out of which long-term liabilities are €4,196,300, which represent deferred revenues from the grants and €227,196 are provision for related parties. While short-term liabilities are €859,398, which are obligations towards suppliers and Tax Administration of Kosovo.

Issue 18 - Incorrect records of Payable Accounts - High Priority

Finding	When testing payables we noticed the following shortcomings:
Finding	Discrepancy between accounting records and letter of confirmation from suppliers. In two letter of confirmations received from suppliers, discrepancies have been noticed with accounting records. In one case the amount of debt confirmed by the supplier is €0, whereas in the accounting notes, the value of the debt to this supplier is €3,171. In the other case, the supplier confirmed the value of €4,534, whereas in the accounting records this value is €5,030. This resulted from incorrect recording and non-compliance with the suppliers; and
Finding	Payables with negative values. In the accounting records there are 10 suppliers whose debt is recorded with negative values, in total of €19,660 This was due to incorrect records.
Risk	Overstatement of liabilities risks the company to pay liabilities to suppliers which it does not owed. Whereas the recording of obligations with negative values reduces the balance of payables resulting in an incorrect value in the AFS.
Recommendation 18	The Chairman of the Board of Directors should ensure that the accounting records are harmonised with the suppliers, while the negative values are handled and recorded in the appropriate accounting records.

3.7 Explanatory Notes

Explanatory notes provide information on the preparation of financial statements and accounting policies, provide disclosures required by IFRS and provide additional information that is not disclosed in the statement of financial position, income statement, statement of cash flow or the statement of changes in equity, but are important to understand each one of them.

Issue 19 - Incomplete presentation of explanatory notes - High Priority

Finding

According to IAS 1, explanatory notes should be presented systematically as possible. Any item in the statement of financial position, income statement, statement of changes in equity or cash flow statement should be referred to the relevant information in the notes.

When analysing the disclosures, the following weaknesses were identified:

- No disclosures were made regarding non-current assets, their depreciation, increases or decreases;
- Stocks were disclosed with the same differences between accounting records and financial statements;
- Incomplete information regarding receivables. As in the statement of financial position and the notes, the balance of receivables was presented differently from accounting records;
- There was no disclosure of advances although their value was €921,394;
- Equity and liabilities explanatory information were not disclosed;
- Incomplete information regarding revenue and service cost; and
- The same presentation of contingent liabilities as in the previous year although during the year funds were withdrawn by the bailiff regarding the cases lost by the enterprise. Further on, no detailed disclosures were made to understand the likelihood of these liabilities incurred.

Risk

The incomplete and inaccurate presentation of the explanatory notes risks that AFS do not give a true and fair view.

Recommendation 19

The Chairman of the Board of Directors should ensure that when preparing AFS detailed, complete and accurate information for each item in the financial statements are presented in the notes.

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 1705[19] 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. Financial Statements - Assets	The auditor recommends that the company establish proper and complete evidence for each asset separately including all costs incurred for significant repair or maintenance so that we have a complete and objective reflection on each asset separately	Implemented		
2. Statement of financial position - Assets	The Auditor recommends that you make frequent reconciliations with your clients and harmonise the notes so that the values match in their entirety. At the minimum before the closing of the financial statements, you should align your notes to the resulting amounts in the accounting records of your customers			Not implemented
3. Statement of financial position - Liabilities – Charter capital	During the audit process, the notes of the charter capital and those of the accumulated and unallocated profits are not reflected as separate but accumulated in a single account with the term "Opening Balance" in which case no performance of the company's financial results is seen in perspective. This finding was also noted in the 2014 statements and the auditor's recommendation remains in force.			Not implemented

4. Statement of financial position - Liabilities - Other payables and trade	The Auditor recommends that after closing of the financial statements at the end of the reporting period, the items of other trade receivables and other payables and trade should be handled according to the obligation or requirement report and not according to the class or the group of accounts. (Additional clarification) If a buyer has made a prepayment to be handled as an obligation towards buyers rather than being broken by the value of other buyers to which the company has claims, the same applies to suppliers			Not implemented
5. Comprehensive income statement	During the audit process, we have noticed disagreement with various sources of assertions “'Comprehensive Company Revenue” since the assertions for the receipts in the trial balance, respectively in the “Comprehensive Income Statement” do not fully correspond to the revenues from VAT tax declarations, the same phenomenon is also noted by the assertions of Operating expenses reflected in TB, respectively in I.S., CFS, which do not correspond fully with the notes of the purchases that belong to the operating expenses of the company, and which are reflected in the tax returns for VAT. This finding was also noted during the audit of the 2014 financial statements, and the auditor's recommendation remains the same.			Not implemented
6. Purchase through the application of minimum procedures	The contracting authority should avoid the frequent use of minimum procedures and use open procedures for the purpose of equal treatment, promotion of competition and achievement of quality according to the principle value for money.			Not implemented