



REPUBLIC OF KOSOVA
OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE MUNICIPALITY OF
PODUJEVA FOR
THE YEAR ENDED 31 DECEMBER 2013

Prishtina, June 2014

The Office of the Auditor General undertakes both Regularity and Performance Audits. The Auditor General Lage Olofsson is the head of the Office of the Auditor General which employs around 145 staff. The Auditor General and the Office of the Auditor General shall be independent and certifies around 90 Annual Financial Statements each year, while undertaking other forms of audits.

Our Mission is to “Contribute to sound financial management in public administration”. We shall perform quality audits in line with internationally recognized public sector auditing standards and good European practices. We shall build confidence in the spending of public funds. We shall play an active role in securing taxpayers’ and other stakeholders’ interests in enhancing public accountability’

The reports produced by the Office of the Auditor General directly promote accountability as they provide a base for holding managers’ of individual budget organisations to account.

The Auditor General has decided on the audit opinion and report on the Annual Financial Statements of the Municipality of Podujeva in consultation with the Assistant Auditor General, Qerkin Morina, who supervised the audit.

The opinion and report issued are a result of the audit carried out under the management of the Audit Director, Florim Beqiri, supported by Lavdim Maxhuni (Team Leader), Elvir Krasniqi, Qëndresa Sogojeva and Shpresa Zenelaj.

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Executive Summary

Introduction

This report summarises the key findings from our audit of the 2013 Annual Financial Statements of the Municipality of Podujeva which determine the Opinion given by the Auditor General. I would like to thank the Mayor and his team for their assistance during the audit process.

The examination of the 2013 Annual Financial Statements was undertaken in accordance with the Internationally Recognised Public Sector Auditing Standards. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated 22.10.2013.

Our audit focus has been on:

- The compliance with the reporting framework and the significant risks to the Annual Financial Statements highlighted in the Audit Planning Memorandum;
- The response to our 2012 and earlier recommendations; and
- The Financial Management and Internal Control of the Municipality (including budget execution and management and Internal Audit)

The level of work undertaken by the Office of the Auditor General to complete the 2013 audit is a direct reflection of the quality of the internal controls implemented by management.

Opinion

Annex I explains the different types of Opinions applied by the Office of the Auditor General. The Auditor General's opinion is:

In our opinion the financial statements *present a true and fair view* in all material aspects.

As an *Emphasis of Matter* Fixed Assets Register is not fully reliable yet because roads and the sewage system identified in the amount of €416,407 were neither recorded in the accounting register nor presented in the AFS. In addition, the Municipality misclassified expenditures and paid the amount of €88,104 from the Category of Capital Investments for goods and services. The Fixed Assets Register and misclassification do not affect any of the two Annual Financial Statements ("Cash Receipts and Payments" and "Comparison of Budget and Actual Amounts") in line with IPSAS Cash based accounting. **(ISSAI 200: Unmodified Opinion with an Emphasis on Matter).**

Overall Conclusion

Our overall conclusion based on the detailed sections of this report is that:

Management of Municipality designed the internal audit system at a satisfactory level, but the system should be constantly monitored in order to ensure operational controls. Areas with shortcomings, which should be the focus of further improvements, are presented as follows:

- The Annual Financial Statements, other than the incomplete disclosure of assets and misclassification of expenditures, where payments for Goods and Services were made from the category of Capital Investments, were prepared in compliance with the Treasury Rule no. 03/2013;
- Prior years and 2012 recommendations were not fully addressed, notwithstanding having some actions undertaken. This resulted in continued control weakness/poor value for money/ potential financial loss;
- IAU has partially fulfilled the work plan. The focus of its scope was the review of operations for the previous years 2011 and 2012.
- Our assessment of Financial Management and Control has identified that although we have been able to take assurance from the effective operation of management controls in a number of account areas, some significant weaknesses exist in important areas of activity. This particularly applies in procurement where contracts have been signed with ineligible economic operators, misclassification of expenditures in economic codes, then poor management of municipal properties leased out. In addition, the municipality did not manage to develop a complete final register of assets owned.

The Auditor General's key recommendations are as follows:

The Mayor should ensure that:

- The 2014 Annual Financial Statements production process formally incorporates management review of the draft accounts with specific focus on areas of registration of all assets in the accounting register and adequate classification of expenditures according to economic categories, and the same should be fairly presented in the Annual Financial Statements;
- Prior years recommendations are handled and addressed according to the importance and priorities by all respective fields' accountable managers where shortcomings have been identified;
- Wider discussions are conducted and a closer cooperation with the internal audit, is established by giving priority to the review of high risk areas.
- Controls over the procurement process are enhanced by adhering to the criteria set out in the Tender Dossier in order that no ineligible bidders is awarded; and
- The assets registration process is carried on and a final register is drafted, which would later be updated on ongoing basis with changes occurring during the year.

Management' response – 2013 audit

The Management has agreed with all our audit findings and has committed itself to address our recommendations.

1 Audit Scope and Methodology

It is the responsibility of the Management to prepare Annual Financial Statements (AFS) under the International Public Sector Accounting Standards (IPSAS) for 'Financial Reporting under the Cash Basis for Accounting' and other specific requirements. The Office of the Auditor General (OAG) is responsible for carrying out a Regularity Audit which involves the examination and evaluation of the AFS and other financial records and expression of opinions on:

- Whether the AFS give a true and fair view of the accounts and financial affairs for the audit period;
- Whether the financial records, systems and transactions comply with applicable laws and regulations;
- The appropriateness of internal controls and internal audit functions; and
- All matters arising from or relating to the audit.

We have considered the extent to which management controls can be relied upon when determining the overall testing required to provide the necessary level of evidence to support the Auditor General's (AG) opinion and the focus of our audit.

The following sections provide a more detailed summary of our audit finding with emphasis on observations and recommendations in each area of review.

For completeness we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

High Priority - issues which 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 improvements to the efficiency and effectiveness of internal controls.

Our procedures included a review of the internal controls and accounting systems and procedures 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. Findings considered of low priority will be reported separately to finance staff.

2 Annual Financial Statements and other External Reporting Obligations

Overall Conclusion

Our review of the AFS considers both compliance with the reporting framework and the quality and accuracy of the information recorded in the financial statements. We also consider the Declaration made by the Chief Administrative Officer (CAO) and Chief Financial Officer when the draft AFS are submitted to the Government.

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 financial statements. A number of the declarations are intended to provide assurance to the Government that all relevant information has been provided to ensure that a comprehensive audit can be undertaken.

2.1 Audit Opinion

Unmodified Opinion¹ with Emphasis on Matter

In our opinion the financial statements *present a true and fair view* in all material aspects

As an *Emphasis of Matter* Fixed Assets Register is not fully reliable yet because roads and the sewage system identified in the amount of €416,407 were neither recorded in the accounting register nor presented in the AFS. In addition, the Municipality misclassified expenditures and paid the amount of €88,104 from the Category of Capital Investments for goods and services. The Fixed Assets Register and misclassification do not affect any of the two Annual Financial Statements (“Cash Receipts and Payments” and “Comparison of Budget and Actual Amounts”) in line with IPSAS Cash based accounting.

(ISSAI 200: Unmodified Opinion with an Emphasis on Matter).

¹ The term, “unmodified opinion” is equivalent to the term, “unqualified opinion” used in our previous year’s reports. The new wording is in accordance with the new INTOSAI audit standards (ISSAI 200). For more information refer to Annex 1.

2.2 Significant Risks to the Annual Financial Statements

Description

Our Audit Planning Memorandum dated 22.10.2013 identified one significant risk to the AFS related to the registration of stock.

The risk of material misstatement that we identified relating to the non registration of stocks did not occur because the municipality has undertaken the necessary and timely actions, and stocks were fairly presented in AFS.

2.3 Compliance with AFS reporting requirements

Description

The AFS are required to comply with a specified reporting framework. We considered:

- Compliance with Financial Rule no. 03/2013;
- Requirements of Law no. 03/L-048 on Public Finance Management and Accountability;
- AFS are submitted within the time framework;
- AFS are signed by CAO and CFO;
- AFS are prepared in Albanian and Serbian;
- AFS are prepared in hard and soft copy; and
- The Municipality submitted regular quarterly reports to Municipal Assembly and a copy to the Minister of MoF during 2013.

Initial AFS contained a number of errors and information was incomplete. Following our suggestions, the Municipality adjusted the AFS and has submitted them for the second time to OAG. Except for incomplete disclosure of assets and misclassification of some expenditure, final AFS were prepared in compliance with the Treasury Rule no. 03/2013.

Issue 1 – AFS Production Process – High priority

Finding In Note 30 - Summary of capital non financial assets - the net value of assets over €1,000 presented in the AFS was €60,911,048. We found that, during 2013, the municipality did not record the roads and sewage system €416,407 in the accounting register and AFS. This amount was not included in the total of assets presented above.

In addition, the municipality misclassified expenditures and payments for goods and services were made from the category of Capital Investments in the amount of €88,104.

Risk Incomplete presentation of assets owned by the Municipality increases the risk that financial position is misunderstood and that asset in AFS are misstated. In addition, misclassification of expenditures may result in understatement of expenditures for Capital Investments and overstatement of goods and services.

Recommendation 1 The Mayor should ensure that the 2014 AFS production plan of accounts formally addresses all requirements for compliance relating to AFS, including the lack of information mentioned.

2.4 Compliance with other External Reporting Requirements

Description

The Municipality is required to address the following external reporting obligations other than producing AFS such as:

- Budget request for capital projects financing;
- Quarterly reports including nine month financial statements;
- The self-assessment report according to FMC rules;
- Draft plan and final procurement plan;
- The action plan for implementation of recommendations; and
- Reports on debts.

Recommendations

We have no recommendations in this area.

3 Prior Year Recommendations

Overall Conclusion

The Municipality management has handled prior year's recommendations and we appreciate the actions undertaken, but all recommendations given were not addressed and remains a challenge.

Description

Our Audit Report on the 2012 AFS resulted in 15 recommendations. Management prepared an Action Plan stating how all recommendations will be addressed.

At the end of our audit, we found that five recommendations have been fully addressed; five are partially addressed or are under the process of addressing, and five have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II at the end of this report.

Issue 2 - Addressing Prior Year Audit Recommendations – Medium Priority

Finding Our Audit Report on the 2012 AFS resulted in 15 key recommendations. The management did not manage to fully address all recommendations; however over half of them have been handled.

Risk Delays in addressing recommendations leads to the risk that previous shortcomings and weaknesses will continue to be present and setbacks will continue in key controls related to respective recommendations.

Recommendation 2 The Mayor should ensure that a revised action plan clearly sets out a timetable for addressing the recommendations made by the AG with accountable staff members identified and with initial focus on those of greatest significance.

4 Financial Management and Control

4.1 Overall Conclusion

Our audit approach is focused on understanding and evaluating the actions taken by management to secure effective financial management and control and the results thereof. For individual financial systems we seek to identify the level at which actual controls operate. We consider whether controls are well designed, but have not been implemented in practice and do not operate effectively. This requires an assessment of structures, processes and accountability lines introduced by management including the role undertaken by Internal Audit and Audit Committee.

We also considered the Municipality's self assessment undertaken in the context of Public Financial Management relating to the Public Internal Financial Control self-assessment.

We found that controls over revenues are not being implemented effectively, controls over a range of expenditure areas require further enhancement to prevent Municipality from suffering financial losses. The main areas where most improvements are required are Procurement, Revenues, and Asset Management.

4.2 Good Governance

Description

The Management has implemented a number of internal controls to ensure that financial systems operate properly. It is important that they include the appropriate reporting with the management to enable an effective and timely response against the operational problems identified.

Issue 3 – Reporting to senior management – High Priority

Finding Our review of the management controls applied to the Municipality's key financial system highlighted an irregular reporting. Reporting to the Mayor is done when needed and there is no written reporting from respective departments on their works and activities. We did not base our audit work on the functioning of high level controls over some economic categories such as; Revenues, Capital Investments, Goods and Services.

Risk Poor quality of financial reporting reduces management's ability to actively manage the operations of the Municipality to react against the financial challenges in time and implement the effective budget control.

Recommendation 3 The Mayor should implement a review to determine the format of financial reporting to senior management required to support effective business management. This should be based on a governance structure where senior management should be informed on control weaknesses and manage them actively.

4.3 Budget Planning and Execution

Description

We have considered the source of budget funds, spending of funds by economic categories and revenues collected. This is highlighted in the following tables:

Table 1 Sources of budget Funds - outturn against the budget (in €)

Description	Initial Budget	Final Budget ²	2013 Outturn	2012 Outturn	2011 Outturn
Sources of Funds	16,521,350	17,395,938	16,666,356	16,574,837	15,909,039
Government Grant - Budget	15,171,350	15,371,350	15,268,355	15,261,145	14,681,146
Carried forward from previous year ³ -		273,447	273,407	241,008	326,875
Own Source Revenues ⁴	1,350,000	1,350,000	816,334	908,441	768,933
Domestic Donations		78,985		604	7,000
External Donations		322,156	308,260	163,639	125,085

The final budget, compared with the initial budget, was higher by €874,588. This increase is a result of Domestic and External Donations in the amount of €401,141, and Revenues carried forward from the previous year in the amount of €273,447. Based on the decision of the Government of Municipality funds in the amount of €200,000 were allocated for Capital Investments.

The Municipality used 96% of the final budget in 2013 or €16,666,356. The 2012 budget was used at around 95%. We may conclude that the Municipality has had high efficiency in the use of budget funds.

² Final budget - the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

³ Own Source Revenues unspent in previous year carried forward into the current year.

⁴ A Portion of the revenues planned and collected in the current year which was used by the entity for financing its own budget.

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

Description	Initial Budget	Final Budget	2013 Outturn	2012 Outturn	2011 Outturn
Spending of funds broken down by economic categories	16,521,350	17,395,938	16,666,356	16,574,837	15,909,039
Wages and Salaries	9,051,828	9,112,554	9,003,807	9,005,424	8,679,102
Goods and Services	1,097,812	1,171,953	1,044,555	1,014,569	933,568
Utilities	305,000	305,000	303,122	283,575	291,759
Subsidies and Transfers	325,000	385,000	349,065	144,316	123,949
Capital Investments	5,741,710	6,421,431	5,965,807	6,126,953	5,880,661

Explanations for changes in budget categories are given below:

- The Capital Investments budget was increased from the carried forward revenues in the amount of €133,270, from donors €346,450 and based on the Government of the Municipality's decision to allocate the amount of €200,000 for capital projects. The budget of this category was used at 92%.
- The Budget for Goods and Services was increased by €74,141. This has increased from revenues carried forward and external donations. The budget of this category was also used at 90%.
- The Subsidies budget was increased from own source revenues carried forward in the amount of €60,000.

Each year Own Source Revenues are not spent as a direct result of budget under spending given that Own Source Revenues are the last source of funding used. In 2014, the carried forward value of Own Source Revenues is over €188,000.

Table 3 Own source revenues budgeted and collected in 2013 (in €)

Description	Initial Budget	Final Budget	2013 Receipts	2012 Receipts	2011 Receipts
Own Source Revenues	1,350,000	1,350,000	1,005,192	1,137,364	1,043,575

Initial budget for Own Source Revenues has not reflected prior year's receipts and other relevant factors. The table shows that the revenues collection was 74%. Compared to the prior year, revenues planned were by 13% lower and compared to 2011 they were lower by 4%.

debts to the Municipality have exceeded the figure of 8.7 million, which presents a significant amount for Municipality, and the balance of the accounts receivable has been constantly increasing. Management of the Municipality should analyse the causes behind the decrease of revenues in the last two years.

Issue 4 – Budget Planning and Execution – High Priority

Finding The Municipality did not plan revenues by specific categories, and we were not able to verify both revenues according to categories and the process achievement compared to the plan. On a general level, the Municipality planned to spend €1,350,000, whereas it managed to collect the amount of €1,005,192 or about 74%.

Risk Lack of a detailed revenues planning reduces the possibility of supervising the achieved progress compared to the management's plan and decision-making to fund projects from own resources.

Recommendation 4 The Mayor should ensure that a stable planning of revenues is made, where the revenue trend over the last years would serve as the starting point and by using other relevant information.

4.4 Revenues (including Own Source Revenues)

Description

The Municipality has established a number of controls over revenues; however, there is a need for further improvements particularly in planning, issuance and implementation of policies and adequate mechanisms for the collection of the previous years remaining debts from property tax, rents and other debts.

The total revenues collected by the Municipality in 2013 were €1,005,192. Property tax, construction licenses, administrative fees, etc were the sources of these revenues.

Issue 5 – Poor execution of Own Source Revenues – High Priority

Finding Based on the data provided by the property tax software, the Municipality billed 16,830 taxpayers in the amount of €616,734 in 2013, whilst €348,938 or 57% were collected. We tested 15 samples in the amount of €47,602, out of which was €23,126 were outstanding. Debts from previous years have amounted to €5,099,044 from €4,482,310 they were the year before.

During 2013, the Municipality collected €38,561 or 1/3 of rents from the total amount of €112,927 contracted for leased out properties. We have tested six samples of €8,548 of the municipal leased out property and found that these users did not pay their obligations at all. The Municipality has undertaken no measures to oblige these users to pay their obligations. Therefore their total debt amounted to €53,629. The total amount of debts towards the Municipality for unpaid rents at the end of 2013 was €590,272.

Around 3,473 businesses operate in the Municipality. The Municipality collected €75,095 of €261,346 or about 29% of charges from the business operation tax. We tested seven samples amounting to €14,797, and in four cases, they did not pay their obligations to the Municipality. The accumulated debt over the years was €3,043,900.

Risk The accumulated/uncollected debts are equivalent to the half of the Municipality's annual budget for 2013. This reflects poor collection policies putting the maximisation of revenues and the achievement of Municipality's objectives at risk as well as reduces the possibility for delivering many self-funding potential projects.

Recommendation 5 The Mayor should implement a systematic review to determine barriers to the increase of the actual revenue collection rate and the decrease of the level of historic debts, and identify possibilities to improve the situation. Reference should be made to other similar Municipalities to determine whether the effective practices in other countries may be applied.

4.5 Expenditures

4.5.1 Procurement

Description

Although the Municipality has designed formal controls over expenditures, they were not operating to the right extent according to our testing. Classification under inadequate economic codes, awarding the ineligible bidders are just some of cases that indicate control weaknesses.

In 2013, expenditures incurred through procurement procedures were €6,954,339.

We analysed whether Capital Investments projects were included in the Public Investment Program and in the Mid-term Expenditure Framework. In addition, we reviewed eventual changes in the projects foreseen to be executed during the year. We have no issue to raise in this report regarding that.

Issue 6 – Non adherence to the criteria set out in the Tender Dossier – High Priority

Finding

In the contract “Paving of road Tërrnavë-Halabak with asphalt” in the amount of €130,825, the criterion in the Tender Dossier was that the Economic Operator (EO) had to submit the list of employees stamped and signed by the Tax Administration of Kosovo (TAK) for 2013. Regardless of this, the winning EO did not bring this evidence.

In the contract “Paving of city streets in asphalt” in the amount of €866,068, the criterion in the Tender Dossier was that EO had to submit a property tax certificate. But, the certificate submitted by the company was not on behalf of the owner and did not meet the Tender Dossier criterion. In addition, the winning company entered into a sub contract for the supply with asphalt which was 71% of the contracted amount. According to the Law on Public Procurement (LPP), the allowed amount to be subcontracted is 40% of the contract.

Risk Administrative procurement requirements were not implemented. Failure to follow procurement procedures and associated guidelines may result in the selection of ineligible bidders. There is a further risk that poor value for money has been achieved related to these contracts.

Recommendation 6 The Mayor should implement a review to determine why procurement requirements were not applied in these cases, implement enhanced controls to ensure that such situations are not repeated and take administrative measures as needed.

Issue 7 – Classification of expenditures in inadequate economic categories – High Priority

Finding In six cases, the Municipality misclassified expenditures in wrong codes, by paying the amount of €88,104 for Goods and Services from the economic category of Capital Investments.

Risk Spending of funds from Capital Investments for Goods and Services may result in the misstatement of expenditures reflected in AFS.

Recommendation 7 The Mayor should ensure that a control system in this area is put in place so that payments are made according to the budget approved per initial allocations.

4.5.2 Remunerations (Wages and Salaries)

Description

Wages and Salaries are paid through a centralised system (payroll). Controls operated locally by the Municipality relate to a) payments monthly control by signing the payroll list, b) verification of potential changes that may appear through forms, c) review of budget for these categories and reconciliations with Treasury.

We tested 56 samples for this category and reviewed the compliance of payroll lists with the payroll system of Ministry of Public Administration. We also reviewed whether officers' positions and multipliers applied are in compliance with the form of the payroll system and the payroll list. Regarding this category, we did not identify any issue to report.

Recommendations

We have no recommendations in this area.

4.5.3 Subsidies and Transfers

Description

The budget planned for Subsidies and Transfers was €385,000, whilst €349,065 were used. In total, we tested 15 samples in the amount of €195,050 for review.

Our review identified no significant shortcomings to be reported.

Recommendations

We have no recommendations in this area.

4.6 Assets and Liabilities

4.6.1 Capital and Non Capital Assets

Description

In 2012, the net value of assets in the accounting register was €52,175,366, while in 2013 it was €60,911,048. The assets value was increased as a result of registrations of land owned by the Municipality. As we may see, the Municipality has carried on with the assets registration process and made progress in 2013, but there remains a lot to be done until the completion of a final assets register.

Issue 8 – Lack of complete and accurate registration of assets - High Priority

Finding The Municipality's assets register was incomplete and inaccurate because assets in the amount of €416,407 were not included in this register.

The Municipality established the stocktaking commission which submitted one report on 20.01.2014.

In addition, while auditing assets under €1,000, we found that records were not kept electronically. As a result, the exact value of assets owned by the Municipality was not known.

Risk Incomplete and inaccurate registration of all assets owned by Municipality and continuous failure to update assets registers increases the risk of understatement/overstatement of the municipality's assets and unfair presentation of the assets value in the AFS.

In addition, lack of electronic records for assets under €1,000 increases the risk that assets are lost or alienated.

Recommendation 8 The Mayor should ensure that the process of the Municipality asset registration continues, with special focus of the registration of newly purchased assets, and that records for assets under €1,000 are kept.

4.6.2 Handling of Receivables

Receivables are amounts which are expected to be collected by the Municipality. These mainly relate to property tax, business tax, and rents.

Issue 9 – Poor collection of property tax, business tax and rents - High Priority

Finding The total value of account receivables presented in the AFS of the Municipality was €8,733,266. We found that the value of accounts receivable has been increasing from one year to the other. Property tax has increased by €616,734 in 2013 compared to 2012; business tax has increased by €172,673, and revenues from rent have increased by €74,115.

Risk Lack of a clear management's strategy on adequate handling of these accounts increases the risk that such receivables are aged, turned into bad debts, and will become uncollectable.

Recommendation 9 The Mayor should prepare an action plan including clear guidelines for the collection of revenue. The plan should contain priorities, allocation of debts based on aging, deadlines on actions to be undertaken and reasons for non payment. A number of collection methods should be applied not excluding legal remedies. The plan fulfilment should be monitored on monthly basis.

4.6.3 Handling of Debts

Description

The statement of liabilities not paid to suppliers at the end of 2013 was €369,499. Out of which, €157,915 belong to the category of Wages and Salaries, and €211,584 to Capital Investments. These liabilities are carried forward to be paid in 2014. The reason for failing to pay these liabilities was lack of committed funds in a number of cases, and for others, was the submission of invoices on the last day of December 2013.

Compared to the 2012, where outstanding liabilities were €280,260, they increased by 31% in 2013.

The Municipality of Podujeva ranks among the 10 municipalities with the most outstanding liabilities. In the future, the Municipality's management should considerably improve the liabilities management in order to avoid the potential lawsuits.

4.7 Internal Audit System

Description

The Internal Audit Unit (IAU) planned to carry out six audits for 2013. It managed to complete three planned audits and one upon Mayor's request. The audits covered years 2011 and 2012. Audits were carried out in the areas: asset management, subsidies, procurement and management of petty cash in the Education Department and Social Welfare Department. Quality of reports and IAU contributions for 2013 were very limited to provide the management with a complete overview on the level of Municipality internal controls.

Audit Committee held four meetings last year. We have reviewed the minutes of meeting and we have not noticed that recommendations given by AG were discussed.

Issue 10 – IAU insufficiently operational and failure to address recommendations given by this unit - High Priority

Finding During the audit, we found that the management has partly implemented recommendations given by IAU.

IAU has partially fulfilled the work plan. The focus of its scope was the review of operations for the previous years 2011 and 2012.

Risk Lack of management ability to address IAU recommendations, as a matter of fact reduces the importance of the role of internal audit and affects its effectiveness. On the other hand, following issues from previous years by the internal audit adds limited value to the improvement of financial and operational performance and to the improvement of current municipality controls.

Recommendation 10 The Mayor should conduct wider discussions and establish a closer cooperation with the internal audit, by giving priority to the review of high risk areas and having assessment of controls and operational activities of 2014 as their scope. In addition, recommendations given by IAU should be addressed by all sectors where control weaknesses and shortcomings have been found.

Annex I: Explanation of the different types of opinion applied by the OAG

(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 II: Prior Year Recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
2. 2 Annual Financial Statements	The Mayor should ensure that all disclosures are complete and included in AFS, in accordance with the requirements set by Treasury rules	Yes		
3. Prior year recommendations	The Mayor should respond more decisively to address the audit recommendations given by audit, handling them in general.		Partially	
4.4.1 Property tax	The Mayor should enhance engagement in the property tax revenue collection with particular focus on the old debts collection.		Partially	
4.4.2 Business activity tax	The Mayor should strengthen outstanding debts collection measures related to this tax or should treat them as uncollectable receivables, if they are treated as bad debts.		Partially	
4.4.3 Rent revenues	The Mayor should implement additional measures to collect rent revenues based on contracts. On the contrary, taxpayers should be prohibited to use the public property.		Partially	
4.5.1 Non execution of tender's guarantee	The Mayor should ensure that all AC procedures and requirements are in accordance with the Public Procurement Law, and especially when seeking confiscation of the tender's guarantee if an economic operator withdraws from the race after the opening of bids.	Yes		

4.5.1.1 Work execution delays	The Mayor should provide valid bank guarantee on all contracts that are exposed to the risk of non - compliance for the entire period of contracts execution. Further, in cases where contracts are not properly implemented, the bank guarantee should be confiscated and determined penalties by contract should be applied.	Yes		
4.5.1.2. Awarding contract with only one eligible bid	The Mayor should ensure that procurement procedures are carried out in accordance with the Public Procurement Law and that internal controls operate throughout the procurement process.			No
4.5.1.3 Classification of economic expenditures in inadequate codes	The Mayor must ensure that the accounting plan for the classification of expenditures within the respective categories is implemented and that payments are made from relevant categories.			No
4.5.2 Personnel records	The Mayor should ensure that personnel records are completed with appropriate documentation in accordance with AI 2003/11 on personnel records and that the same are continuously updated.			No
4.5.3 Granting subsidies without Municipal Assembly's approval	The Mayor should ensure that in the future, he will implement this rule and that all the criteria and procedures for granting of Subsidies are applied.	Yes		
4.6 Assets	The Mayor should provide a recording process for all material stocks at the end of every year and should compare record results with those of accounting records. Differences should be clarified	Yes		

4.6.1 Handling of receivables	The Mayor should take concrete measures to increase the collection of receivables, by establishing a process which ensures that receivables are recorded soon after invoicing.			No
5 Insufficient IAU activity	The Mayor should ensure that the IAU is carrying out planned audits and that the focus is on high - risk assessed areas, such as: revenues, expenditures, procurement, contract management, etc.			No
5.1 Addressing IAU recommendations	The Mayor should draft an Action Plan, which considers that internal audit findings and recommendations are discussed and addressed by all management levels.		Partially	