



REPUBLIC OF KOSOVO
OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE MUNICIPALITY OF
SHTERPCE FOR THE YEAR ENDED 31 DECEMBER 2011

Prishtina, June 2012

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List of abbreviations

AC	Audit Committee
AFS	Annual Financial Statements
APR	Annual Performance Report
CHU/IA	Central Harmonisation Unit of Internal Audit
FM/C	Financial Management and Control
FR	Financial Rules issued by the Ministry of Finance
IA	Internal Audit
IAS	International Accounting Standards
IAU	Internal Audit Unit
IFAC	International Federation of Accountants
INTOSAI	International Organisation of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISSAI	International Standards of Supreme Audit Institutions
KFMIS	Kosovo Financial Management Information System
LIA	Law on Internal Audit
LPFMA	Law no. 03/L-048 on Public Finance Management and Accountabilities
LPP	Law on Public Procurement no 03/L-241 as amended with Law no. 04/L-042 applicable from 05.10.2011
MoF	Ministry of Finance
OAG	Office of the Auditor General
PIFC	Public Internal Financial Control
PRB	Procurement Review Body
SAI	Supreme Audit Institution

Executive Summary

The Office of the Auditor General (OAG) has carried out an audit of the Annual Financial Statements of the Municipality of Shterpce for the year ended 31 December 2011.

Our audit was carried out in accordance with international auditing standards issued by INTOSAI and included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements.

In our opinion the Annual Financial Statements in all material aspects *present a true and fair view*.

We would like to draw your attention to the fact that the Municipality of Shterpce has not disclosed completely and accurately the information on assets and stocks. This does not affect the opinion on the AFS drafted in line with IPSAS Cash based accounting. **(ISSAI 400 Unqualified Opinion with an Emphasis of Matter)**

During 2011, the Municipality of Shterpce has not handled properly the recommendations given earlier in our audit report for 2010. The Municipality of Shterpce has not prepared a plan to address recommendations, and none of the recommendations were addressed.

Our audit has identified weaknesses in several areas of financial management. These weaknesses are described more in detail in the report.

Our overall conclusion is that Municipality of Shterpce management needs to undertake further corrective actions and encourage establishment of internal controls in all areas.

In order to improve the functioning of financial management system and internal controls in the short run, we recommend the Mayor to ensure that:

- Clear policies, procedures and guidelines for all processes/important activities such as budget planning, procurement, management of capital expenditures and reporting are issued.
- Budget is prepared based on annual objectives and adapting it with the needs that are feasible and followed by a clear cash flow time plan;
- Procurement plan is prepared on time and is used as a base for setting the budget. Furthermore, the monitoring of contracts will improve;
- A regulation on the giving of subsidies is introduced;
- All assets are recorded and recordkeeping is done in accordance with AI 21/2009;
- Functioning of internal control Improves; and
- The role of the internal audit is strengthened, and Audit Committee established.

The Management of Shterpce Municipality has acknowledged our findings and conclusions presented in the audit report on the AFS for the year 2011 and are committed to make every effort to address all recommendations given.

1 Introduction

This audit relates to the annual financial statements of Municipality of Shterpce for the year ended 31 December 2011.

It is the responsibility of Municipality of Shterpce to prepare financial statements in accordance with the Financial Rules 07/2011 and International Public Sector Accounting Standards (IPSAS) for "Financial Reporting under the Cash Basis of Accounting".

The Office of the Auditor General is responsible for carrying out annual regularity audits of in the Municipality of Shterpce.

A Regularity Audit is defined as an attestation of financial accounting, involving examination and evaluation of Financial Statements and other financial records and expression of opinions on:

- Whether the financial statements 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 carried out an interim audit in the Municipality of Shterpce. During that stage of the audit process we addressed how the Municipality of Shterpce has handled recommendations given earlier and the quality of financial management. Based on this we have given advices to the management. This also included advice related to the preparation of the Annual Financial Statements. An audit memo was submitted the date in this case December 2011.

In order to fulfil our responsibilities for the audit of Municipality of Shterpce, we have undertaken the following activities:

- Reviewed the Annual Financial Statements of Municipality of Shterpce against the approved budget for 2011;
- Undertaken extensive substantive testing of financial transactions; and
- Established a materiality level of revenues and expenditures, as a threshold for assisting in determining the type of opinion to render on the financial statements;

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- Relied on a combination of interviews, analytical reviews, document reviews, and physical verification to assess the validity and propriety of financial transactions;
 - Determined whether the Annual Financial Statements of Municipality of Shterpce were prepared in accordance with IPSAS “Financial Reporting under the Cash Basis of Accounting”; and
 - Assessed whether the Internal Audit in Municipality of Shterpce is operational.

In this report we summarise this year’s audit and give a formal opinion on the Annual Financial Statement 2011.

Related to our audit opinion on AFS of Shterpce Municipality, the ISSAI’s set out specific criteria that govern the type of opinion that can be rendered.

These are set out more fully in Annex 1.

2 Audit Opinion

In our opinion the Annual Financial Statements in all material aspects present *a true and fair view*.

We would like to draw your attention to the fact that the Municipality of Shterpce has not disclosed completely the information on assets. This does not affect the opinion on the AFS drafted in line with IPSAS Cash based accounting. **(ISSAI 400 Unqualified Opinion with an Emphasis of Matter)**

3 Status of Prior Years Recommendations

The opinion for AFS for 2010 was qualified opinion. The basis for this was qualification was:

- The Municipality of Shterpce has not disclosed in the notes to the Statements, the government grants received from the KCB as required by Article 10 paragraph 4 of Administrative Instruction 16/2010.
- The Municipality of Shterpce has not disclosed in the notes to the Statements, information related to fixed assets as required by Article 15 paragraph 1 and 2 of Administrative Instruction 16/2010 (2009: 20/2009).

In the audit report of AFS for 2010 (4) recommendations were given. Neither one of these recommendations was addressed. Prior years' recommendations are presented in the Annex II of this report.

Failure to address our recommendations fully has led to the same problems as in prior years. The fact that recommendations we have given were not addressed indicates lack of readiness by the management to take corrective actions. In addition, until appropriate actions are undertaken the shortcomings illustrated above will continue to exist.

The mayor and managers responsible for areas where weaknesses and managerial deficiencies are identified should discuss an action plan in order to take measures to address issues raised by the audit.

4 Financial outcome compared to approved budget

Analysis of Financial Statement outcome against the approved budget indicates:

Table 1: Overview of the budget and expenditures In euro (€)

Description	Initial Budget	Final Budget	Receipts/expen ditures 2011	Receipts/expen ditures 2010
Government Grant -Budget	2,839,062	4,165,017	3,625,023	3,645,911
Own Source Revenues of 2011	69,035	189,806	237,000 ¹	114,263
Carried forward from 2010	0	50,724	50,724	34,119
Domestic Donations	0	0	0	0
External Donations	0	31,307	28,904	12,130
I. Receipts and transfers of donations Total	2,908,097	4,436,854	3,941,651	3,806,423
Wages and Salaries	1,871,386	1,750,987	1,338,840	1,001,991
Goods and Services	327,257	469,612	340,372	177,908
Utilities	51,442	55,942	55,941	33,154
Subsidies and Transfers	10,314	10,314	10,314	5,600
Capital Investments	647,698	2,149,999	2,144,908	2,537,046
Reserves	0	0	0	
II. Total of Expenditures	2,908,097	4,436,854	3,890,375	3,755,699
Difference I-II	0	0	51,276	50,724²

From the table we can see that the Final Budget is larger than the Initial Budget by €1,528,757. Under the Prime Minister's decision no. 01/142 of date 26.08.2011 the budget has increased in the category of Capital Investments for €1,323,000, in the category of Wages and Salaries by €2,955, in the category of Own Source Revenues by €171,495 and Donations in amount of €31,307.

The difference in amount of €51,276 is Own Source Revenues that were not spent and carried forward in 2012.

¹ Own source Revenues collected in 2011

² Municipality Own Source Revenues in previous year carried forward into the current year

The total of expenditures was lower €546,479 than the Final Budget i.e. the Final Budget was spent approximately 88%. More emphasised surplus was noticed in the category of Wages and Salaries in amount of €412,147, as the Municipality of Shterpce did not manage to recruit 119 secondary health care employees as planned.

Conclusion

Only in the last quarter, the Municipality of Shterpce has spent 52% of the total budget, which is an indicator that budgets drafting and execution policies require substantial improvement. Not spent by 12% compared with final budget, indicates a need for strengthening budgetary controls.

Recommendation 1

We recommend the Mayor of Municipality to ensure that:

- The Budget is prepared only after a comprehensive analysis on realistic needs. Moreover, the cash flow plan needs to be reconciled with annual procurement activities (dynamics on execution of capital projects and supplies with goods and services).

5 Financial Statements - Compliance with reporting framework and the quality of information

The Municipality of Shterpce has prepared the AFS in accordance with the Financial Rule No. 07/2011 on annual reporting of budget organisations, except for disclosure of fixed assets.

Requirements in LPFMA No. 03/L-048 and Financial Rule No. 7/2011.

- AFS have been signed by the Chief Administrative Officer and Chief Financial Officer;
- AFS are signed within the required time frame on 31/01/2012 and Submitted to MoF;

AFS were submitted in Albanian and Serbian Language; and

- The value of fixed assets owned by the Municipality of Shterpce was not disclosed in the AFS.

Conclusion

The AFS of Municipality of Shterpce in general provide information in accordance with financial reporting rules under cash accounting, except for the shortcoming of assets disclosure. In spite of the recommendation given last year, the Municipality of Shterpce has not undertaken appropriate actions for reporting of assets.

Recommendation 2

We recommend the Mayor of Municipality to ensure that:

- All assets are presented in the AFS as a legal requirement, and with this to complete the information needed.

6 Financial management

Own source revenues

Own source revenues collected by the Municipality of Shterpce for 2011 were in amount of €237,000.

In our first audit phase of own source revenues we have noticed two shortcomings:

- Own source revenues between the departments and the revenues officer were not reconciled and
- Revenues collected were not deposited in the bank on daily basis.

During the interim audit phase, we have advised Municipality of Shterpce management to eliminate these shortcomings and we have noticed that our advice was accepted and these weaknesses were eliminated.

We have checked the documentation available and have not identified any significant shortcomings in calculation and collection of revenues. Revenue Officer now regularly conducts reconciliations with departments and the Central Bank.

Expenditures

Procurement

We have noticed that the Municipality of Shterpce did not have a final procurement plan for 2011.

The value of signed contracts was in amount of €2,374,028. We have tested 34 samples that cover payments and expenditures carried out through procurement procedures that amount to €1,518,412. We noticed that in 16 cases there were delays in completion of works. Only in one case were imposed penalties as set out under the contract.

Conclusion

The fact that the Municipality of Shterpce did not have a final procurement plan has a direct impact on projections of the budget and its execution. The planning policies have to improve substantially. In addition, numerous of delays in projects are an indicator that contracts monitoring is poor.

Recommendation 3

We recommend the Mayor of Municipality to ensure that:

- The annual procurement plan that clearly specifies all projects and supplying needs will be prepared; and
- Contracts monitoring controls are strengthened so that works or supplies are delivered within the deadlines set out in the contract.

Remunerations (wages and salaries)

Approved budget of the Municipality of Shterpce for the category of Wages and Salaries was in amount of €1,750, 987, and expenditures incurred were in amount of €1,338,840, or 76,5% of this category's budget. The reason why this category's funds were not spent is since 119 secondary health care employees were not recruited, since the hospital was not built yet.

We have tested 29 samples and have not come across any shortcomings worth reporting.

Subsidies and transfers

Total expenditures for subsidies were in amount of €10,3140. We have examined six sample units that amounted to €2,496 or 24% of the total. In doing this we have not noticed any shortcomings apart from the fact that the Municipality of Shterpce does not have a Regulation on subsidies. The Mayor has allocated subsidies based on applicants' requests solely.

Conclusion

The Lack of regulation on allocation of subsidies may have an impact on irrational use of this category's budget and possible favouritism towards candidates when the subsidies are given.

Recommendation 4

We recommend the Mayor of Municipality to ensure that:

- An internal regulation is prepared that clearly specifies the criteria and procedures for allocation of subsidies in order to prevent any eventual irregularities.

Assets

Capital and non capital assets

The Municipality of Shterpce does have an Assets Officer. although He has not managed to record, valuate and inventory the assets for 2011, in order to verify their physical existence, how they are managed and their value. A commission for valuation and recording of assets was established. However, the commission has not completed its work yet and have not presented any reports to us concerning their work performed. In our discussions with the management they have committed themselves that they will complete the central assets registry and entirely implement the AI 21/2009 no later than by the end of 2012.

Conclusion

The current audit findings on assets are repeated from 2007. In spite of this, we have not noticed any positive changes up until now.

Recommendation 5

We recommend the Mayor of Municipality to ensure that:

- Assets register is completed in accordance with Administrative Instruction No. 21/2009 on recording and assets management.

Current reporting and timeliness in the overall budget process

The Municipality has submitted:

- Quarterly reports including nine month financial statements in time;
- Reports on debts submitted in MoF;

The Municipality of Shterpce has not prepared a plan to address the recommendations given for 2010.

7 Management Control

7.1 Internal Control Systems

The Municipality of Shterpce did not manage to establish functional internal control systems. Furthermore, the management does not sufficiently encourage the development of internal controls. Failure to address audit recommendations from year to year is an indicator that the readiness for undertaking corrective actions and establishing appropriate controls is missing.

We also noticed weaknesses and incorrect approach during the planning of the budget. The budget is not based on proper analysis and is not reconciled with Municipality of Shterpce operational activities. Failure to prepare procurement plans in time has resulted in inaccurate planning and execution of the total budget. Consequently, the surpluses arise, whereas many of realistic requests are likely to remain unfulfilled. In addition, there are no controls over the allocation of expenditures during the periods, which resulted in spending half of the budget in the last quarter.

Own source revenues are collected approximately by 25% more than planned. This collection does not indicate good planning instead, it is more of an ad hoc planning, since own source revenues participate only by 6% in the financing structure. This demonstrates a need for more comprehensive analysis on taxes and fees imposed to legal and natural persons.

The monitoring of contracts is poor. Delays in execution of projects are evident in many cases and the management did not impose penalties to operators.

Without doubt, the most problematic is the area of assets management. After all these years, and the Municipality of Shterpce does not have an assets officer neither assets register. One of the main objectives of the PIFC is protection and proper management of assets. On occasions when accounting records and physical count of assets are missing, a good management becomes impossible.

Conclusion

The internal control system requires establishment of clear control guidelines and procedures. Currently, the internal controls do not ensure that objectives set by the Municipality of Shterpce will be achieved.

Recommendation 6

We recommend the Mayor of Municipality to ensure that:

- Internal control is reviewed properly and normatively defines internal control procedures and identification of risk and to create an efficient information and communication flow within the organisation.

Internal Audit

The Municipality of Shterpce has established an Internal Audit Unit (IAU) that consists of only one member who is also the Director. The IAU has not produced any audit reports for 2011. The annual strategic plan was prepared. During the audit, we did not have any available reports from the IAU for 2011. All the reports prepared by the IAU refer to 2010.

The Municipality of Shterpce has not yet established an Audit Committee.

Conclusion

In our opinion, the IAU should have dealt with current year issues by identifying weaknesses and possible irregularities on time, and give suggestions, proposals and recommendations to the management in order to contribute in addressing and their implementation.

The IAU did not manage to implement the annual work plan. This does not help Municipality of Shterpce management to have a clear view on controls effectiveness.

Failure to establish an Audit Committee, which is a legal obligation results with lack of adequate control over the work of IAU and control over the implementation of advices, suggestions and possible recommendations issued by the IAU.

Recommendation 7

We recommend the Mayor of Municipality to ensure that:

- The IAU mainly focuses on the current year and in areas such as procurement and assets and
- An Audit Committee is established in the shortest time possible, which would strengthen the internal audit function.

8 Overall conclusion on the Management of Shterpce

Overall conclusion

Our overall conclusion is that Municipality of Shterpce management needs to undertake further actions and encourage establishment of internal controls in all areas.

The PIFC is a basic document and should be familiar to all managers and Municipality of Shterpce staff. The need to increase transparency and accountability at all levels of the organisation is a fundamental requirement for building good governance structure. The financial management procedures and controls within the PIFC framework should be clear to all so that they can implement them. The proper knowledge level and skills of the management should be appreciated to ensure successful implementation of PIFC framework requirements.

The management of Municipality of Shterpce has to permanently provide reliable financial reports and assess the risk on occurrence of material errors and irregularities in the Annual Financial Statements. The assets management risk should be assessed on cases when records or complete registers are missing.

Overall recommendations

We recommend the Mayor of Municipality to ensure that:

- Clear policies, procedures and guidelines are issued for all processes/important activities such as budget planning, procurement, management of capital investment expenditures and reporting.

Annex I. Different types of audit opinions

(extract from ISSAI 400)

9. An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse (paragraph 14) or a disclaimer (paragraph 15) of opinion.

10. **An unqualified opinion** is given when the auditor is satisfied in all material respects that:

- a) the financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;
- b) the statements comply with statutory requirements and relevant regulations;
- c) the view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and
- d) there is adequate disclosure of all material matters relevant to the financial statements.

11. **Emphasis of Matter.** In certain circumstances the auditor may consider that the reader will not obtain a proper understanding of the financial statements unless attention is drawn to unusual or important matters. As a general principle the auditor issuing an unqualified opinion does not make reference to specific aspects of the financial statements in the opinion in case this should be misconstrued as being a qualification. In order to avoid giving that impression, references which are meant as "emphasis of matter" are contained in a separate paragraph from the opinion. However, the auditor should not make use of an emphasis of matter to rectify a lack of appropriate disclosure in the financial statements, nor as an alternative to, or a substitute for, qualifying the opinion.

12. An auditor may **not be able to express an unqualified opinion when** any of the following circumstances exist and, in the auditor's judgement, their effect is or may be material to the financial statements:

- a) there has been limitation on the scope of the audit;
- b) the auditor considers that the statements are incomplete or misleading or there is an unjustified departure from acceptable accounting standards; or
- c) there is uncertainty affecting the financial statements.

13. **Qualified Opinion.** Where the auditor disagrees with or is uncertain about one or more particular items in the financial statements which are material but not fundamental to an understanding of the statements, a qualified opinion should be given. The wording of the opinion normally indicates a satisfactory outcome to the audit subject to a clear and concise statement of the matters of disagreement or uncertainty giving rise to the qualified opinion. It helps the users of the statements if the financial effect of the uncertainty or disagreement is quantified by the auditor although this is not always practicable or relevant.

14. **Adverse Opinion.** Where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position presented to the extent that an opinion which is qualified in certain respects would not be adequate, an adverse opinion is given. The wording of such an opinion makes clear that the financial statements are not fairly stated, specifying clearly and concisely all the matters of disagreement. Again, it is helpful if the financial effect on the financial statements is quantified where relevant and practicable.

15. **Disclaimer of Opinion.** Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to an uncertainty or scope restriction which is so fundamental that an opinion which is qualified in certain respects would not be adequate, a disclaimer is given. The wording of such a disclaimer makes clear that an opinion cannot be given, specifying clearly and concisely all matters of uncertainty.

16. It is customary for SAIs to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.

Annex II. Prior Years' recommendations

Audit Component	Recommendation given	Recommendation fully implemented	Partly addressed	Not addressed
1. Financial statements	Preparation of AFS in full accordance with Financial Rule No. 07/2011.			X
2.1 Personnel	Compensation of staff is done in accordance with applicable laws and Administrative Instruction currently in force.			X
2.2 Procurement	Procurement procedures applied should be in accordance with LPP;			X
1.1 Assets management	Assets should be recorded in accordance with AI no.21/2009.			X
Total	4	0	0	4