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National Audit Office

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AUDIT REPORT
ON THE ANNUAL FINANCIAL STATEMENTS OF THE
MUNICIPALITY OF ISTOG FOR
THE YEAR ENDED 31 DECEMBER 2017

Prishtina, May 2018

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 through quality audits strengthen accountability in public administration for an effective, efficient and economic use of national resources.

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 Municipality of Istog in consultation with the Assistant Auditor General, Valbon Bytyqi, who supervised the audit.

The report issued is a result of the audit carried out by Arian Haxha (Team Leader) and Fanol Hodolli (team member) under the management of the Head of Audit Department Luljeta Morina.

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Executive Summary

Introduction

This report summarises the key issues arising from our audit of the 2017 Annual Financial Statements of Municipality of Istog, which determines the Opinion given by the Auditor General. The examination of the 2017 financial statements was undertaken in accordance with the International Standards on Supreme Audit Institutions (ISSAIs). 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 dated 21/11/2017.

Our audit focus has been on:



The level of work undertaken by the National Audit Office to complete the 2017 audit is determined depending on the quality of internal controls implemented by the Management of the Municipality of Istog.

The National Audit Office acknowledges Municipality's Senior Management and Staff for cooperation during the audit process.

Opinion of the Auditor General

Unmodified Opinion with Emphasis of Matter

The Annual Financial Statements for 2017 *present a true and fair view* in all material aspects.

Emphasis of matter

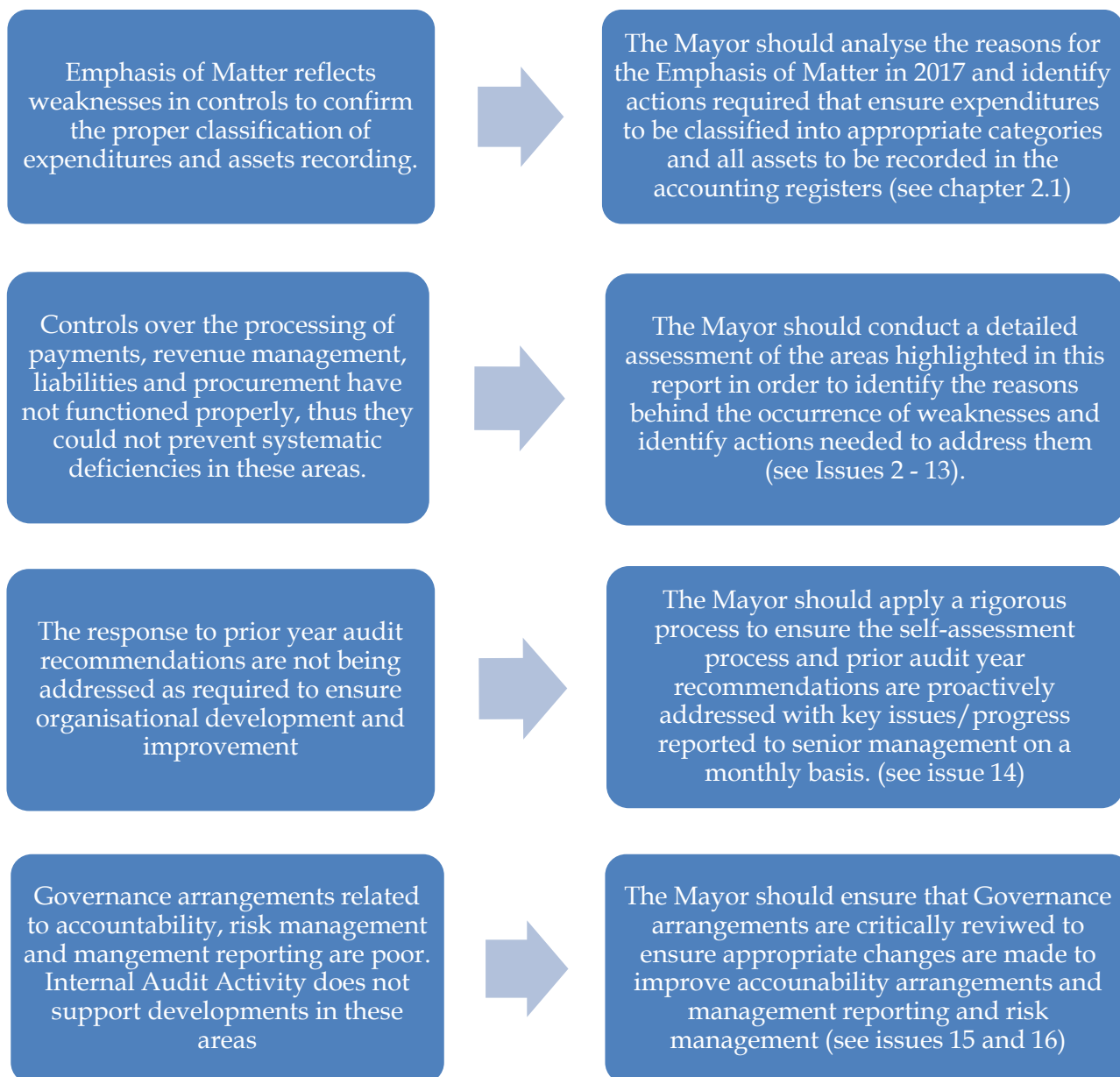
As an emphasis of matter, we would like to mention the fact that:

- €116,491 were incorrectly budgeted from the category of Capital Investments and spent for projects which by nature belong to the category of Goods and Services and Subsidies;
- 1,540 municipal parcels of land were not yet recorded in assets register; and
- Register of assets under €1,000 (e-assets) has not yet been updated with data of previous years' assets in the Health and Education sector.

For more details see Section 1.2 of this report.

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

Key Conclusions and Recommendations



Management response to audit 2017

The Mayor has considered and agreed on the audit findings and conclusions and has committed to address all given recommendations.

1 Audit Scope and Methodology

Introduction

The National Audit (NAO) is responsible for carrying out a Regularity Audit which involves the 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.

Audit work undertaken reflected our audit risk assessment for Municipality of Istog. We have analysed Municipality's business to 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 AG's opinion.

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

Our procedures included a review of the internal controls, accounting systems and related substantive tests and related governance arrangements 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.

2 Annual Financial Statements and other External Reporting Obligations

Introduction

Our audit of the Annual Financial Statements (AFS) considers both compliance with the reporting framework and the quality and accuracy of information recorded in the AFS. We also consider the Declaration made by the Chief Administrative Officer and Chief Financial Officer when the draft AFS are submitted to the Ministry of Finance.

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 assertions are intended to provide the Government with the assurance that all relevant information has been provided to ensure that an audit process can be undertaken.

2.1 Audit Opinion

Unmodified Opinion with Emphasis of Matter

We have audited the AFS of the Municipality of Istog for the year ended on 31st of December 2017 which comprise of the Statement of Cash Receipts and Payments, Budget Execution Statement and other accompanying reports.

In our opinion, the Annual Financial Statements for the year ended on 31st of December 2017 present a true and fair view in all material respects in accordance with International Public Sector Accounting Standards (cash based Accounting), Law no.03/L-048 on Public Finance Management and Accountability (as amended and supplemented) and Regulation no.01/2017 on Annual Financial Reporting of Budget Organisations issued by the Ministry of Finance.

Basis for the opinion

Our audit was conducted 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. We believe that the obtained audit evidence is sufficient and appropriate to provide a basis for the opinion.

Emphasis of Matter

We draw your attention to the fact that some of the expenditures have been budgeted and spent from inadequate categories. Municipality has incorrectly classified payments for projects¹ as capital investments in the amount of €116,491, which according to the Administrative Instruction 2005/08 they belong to the category of Goods and Services (€88,255), and Subsidies (€28,236).

Municipal assets continue to be understated as a result of not registering 1,540 municipal land parcels. Furthermore, the register of assets under €1,000 is not accurate as previous years' purchases for the sector of Health and Education are not included yet in the e-assets register.

Our opinion is not modified for this issues.

Responsibility of Management and Persons Charged with Governance for AFS

The Mayor of Municipality of Istog is responsible for the preparation and fair presentation of financial statements in accordance with International Public Sector Accounting Standards – Financial Reporting under the Modified Cash based Accounting and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. This includes the application of Law number 03/L-048 on Public Finance Management and Accountability (as amended and supplemented).

The Mayor is responsible to ensure the oversight of Municipality's financial reporting process.

Auditor General's Responsibility for the Audit of the AFS

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

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will detect any material misstatement that might exist. 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

¹ Supporting beekeepers with bee colonies and beehives; Establishment of greenhouses; summer and winter maintenance of roads (cleaning of snow and waste); and Maintenance of Parks and Disposal of Waste.

the entity's circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

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

2.2 Compliance with AFS and other reporting requirements

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

- Compliance with MoF Regulation no.01/2017 on the Annual Financial Reporting of Budget Organisations;
- Requirements of LPFMA no. 03/ L-048, (as amended and supplemented);
- Compliance with Financial Rule no.01/2013 on spending of public money;
- Compliance with Financial Rule no.02/2013 on assets management;
- Action Plan on implementation of recommendations;
- Requirements of Financial Management and Control (FMC) procedures.
- Initial and final procurement plan;
- Regular quarterly reports for the Municipal Assembly and discussion of reports of IA and NAO by the MA; and
- Regular quarterly reports for the Treasury, including nine-month financial statements.

Given the above - the Declaration made by the Chief Executive Officer and Chief Financial Officer when the draft AFS are submitted to the Ministry of Finance can be considered to be correct, even though there are disclosure errors, which have not affected the audit opinion.

In the context of the AFS we have no issues to raise.

2.3 Recommendations related to Annual Financial Statements

For the issue mentioned above as an emphasis of matter at the audit opinion, we give the following recommendation, such as:

Recommendation 1 The Mayor should ensure that an analysis is undertaken to determine the causes of emphasis of matter, and that are undertaken specific actions to address underlying causes in a systematic manner to remove errors in classification expenditures and assets disclosures. All expenditures should be budgeted and recorded in in line with the accounting plan. Furthermore, all assets, including properties and non-financial assets should be recorded in assets registers.

Furthermore, the Mayor should ensure that effective processes are in place to confirm that the 2018 AFS production plan formally addresses all compliance issues related to the AFS and includes Management review of the draft AFS with specific focus on high risk areas and/or areas where errors have been identified in previous years. The Declaration made by the Chief Administrative Officer and Chief Financial Officer should not be signed unless all necessary checks have been applied to the draft AFS.

3 Financial Management and Control

Introduction

Our work related to Financial Management and Control (FMC) reflects the detailed audit activities undertaken on Revenue and Expenditure Systems within Budget Organisations. Specifically, the focus of the audit was Budget management, Procurement issues, Human Resources as well as Assets and Liabilities.

Financial Management and Control Conclusion

In the context of financial systems, controls over a number of areas over a range of revenues and expenditures require further enhancement.

The key areas where more improvements are needed are procurement procedures as in some cases legal requirements are not being implemented upon development of procurement activities, planning and budget execution, reporting and payment of liabilities, as well as assets management.

3.1 Budget Planning and Execution

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

Table 1. Sources of budgetary Funds (in €)

Description	Initial Budget	Final Budget ²	2017 Outturn	2016 Outturn	2015 Outturn
Sources of Funds	9,357,206	9,825,750	8,853,886	8,846,553	8,878,415
Government Grant -Budget	8,130,511	8,130,512	7,734,102	7,865,277	7,711,699
Carried forward from previous year ³ -	-	412,639	333,027	145,246	391,906
Own Source Revenues ⁴	1,226,695	1,226,695	751,223	721,525	742,835
Domestic Donations	-	55,901	35,534	24,334	31,975
External Donations	-	3	-	90,171	0

The final budget is higher than the initial budget by €468,544. This increase is a result of donations and revenues carried forward from the previous year, totalling to €412,639.

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 Receipts used by the entity for financing its own budget.

Municipality used 90% of the final budget in 2017 or €8,853,886, a decrease of 6% compared to 2016 (96%).

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

Description	Initial Budget	Final Budget	2017 Outturn	2016 Outturn	2015 Outturn
Spending of funds by economic categories	9,357,206	9,825,750	8,853,886	8,846,553	8,878,415
Wages and Salaries	5,799,714	5,805,379	5,638,899	5,675,925	5,519,858
Goods and Services	853,700	893,054	764,047	782,425	810,343
Utilities	117000	119,598	118,580	145,532	161,046
Subsidies and Transfers	223,813	296,916	262,018	201,391	327,545
Capital Investments	2,362,979	2,710,803	2,070,342	2,041,280	2,059,623

Explanations for changes in budget categories are given below:

- The increase of the final budget for wages and salaries compared to the initial budget was as a result of an increase carried forward in the amount of €5,665. Budget execution in this category was at 97;
- In addition, the increase of the final budget for Goods and Services and Subsidies and Transfers is as a result of the increase of revenues carried forward in the amount of €39,354 in the category of Goods and Services and €73,102 for subsidies. Budget execution for goods and services was 86%, while in the category of Subsidies and Transfers was 88%; and
- The final budget for capital investments compared to the initial budget had increased by €347,824. The increase was as a result of revenues carried forward in the amount of €292,923, and donor grants in the amount of €56,901. Despite the budget increase for capital expenditures during 2017, only 76% of the budget was spent. Delays relate to some projects launched at the end of 2017.

Issue 2 - Low level of budget execution for capital investments

Finding A challenge for the Municipality remains low level of budget execution in the category of Capital Investments, at only 76%, which resulted in a surplus of over €600,000. The low level of execution was mainly due to delays in the development of procurement procedures.

Furthermore, a significant part of expenditures was incurred in the last quarter, capital investments at 63% and goods and services at 43%.

Risk Low budget execution reduces effectiveness of organization's annual plans. Due to the failure to fulfil the capital investments program will result in fewer implementation of projects, which will affect the quality of services to citizens.

Recommendation 2 The Mayor should ensure that budget performance is systematically monitored on a monthly basis and that this review identifies and addresses barriers that hinder timely and planned level of budget execution. If initial budget planning is inaccurate, this should be fully reflected in the final budget position.

3.2 Revenues

Revenues generated by the Municipality of Istog in 2017 totalled €843,036. These relate to revenues from property tax, revenues from construction licenses, administrative fees, revenues from business activities, revenues from rent etc.

Table 3. Own Source Revenues (in €)

Description	Initial Budget	Final Budget	2017 Receipts	2016 Receipts	2015 Receipts
Own source revenues	1,226,695	1,226,695	843,036	1,061,435	941,133
Total	1,226,695	1,226,695	843,036	1,061,435	941,133

Property tax invoiced during 2017 was €348,493, out of which was collected €173,665 or 50%. In addition to the revenues presented in the table, Municipality of Istog had also collected indirect revenues from traffic fines in the amount of €136,323.

Issue 3 - Failure to verify the current status of properties

Finding The Municipality had not verified 1/3 of properties as required under the Administrative Instruction no. 03/2011, Article 13. Out of 10,405 properties recorded in the property tax database, Municipality has managed to verify only 395 registered properties, or only 4%.

Risk Poor property verification may result in incomplete information on current taxable property, and in inaccurate estimation of property tax revenues.

Recommendation 3 The Mayor should ensure that verification of immovable properties for the purpose of property tax is done in accordance with rules, so that potential changes are integrated into existing property database. An increase of property registration will result in more municipal revenues and better budget performance.

Issue 4 - Inadequate management of leased municipal properties

Finding The Municipality has temporary leased 61 municipal properties, whereby has avoided the process of public auction, and lease prices were not set in accordance with the Regulation no. 23/2013. During this year, 36 beneficiaries of municipal property had not paid rent at all, and the Municipality had not taken any actions to collect these funds. Moreover, in 11 cases, contracts for leased property were not valid due to expiration. Only in one case during 2017, the contract for leased property was extended based on the old law which had been repealed a while back.

Risk Weaknesses identified may result in limited competition or less revenue from this category and unequal treatment of parties when setting flat-rate prices. Lack of control and failure to apply adequate measures makes it impossible to collect revenues from lease and increases the risk of aging claims. In addition, operating with expired contracts deprives the municipality of the right to collect revenues and to follow legal proceedings if debts are not collected on time.

Recommendation 4 The Mayor should analyse the reasons behind inadequate management of municipal property and ensure that municipal immovable property is used only when legal requirements are met in accordance with the rules. In addition, all possible options should be considered in an active manner, including legal means to ensure that agreed revenues are collected.

3.3 Salaries and wages

The Municipality managed to use 97% of the final budget for wages and salaries that are paid through a centralized payment system that is managed by the Ministry of Public Administration and MoF. Key controls applied by the Municipality are monitoring and signing of payroll lists by competent officials.

Issue 5 - Weakness in staff engagement under special service agreements

Finding

According to the Law No. 03/L-149 on Civil Service (Article 12, clause 4), "Fixed-term appointments of less than six (6) months shall be governed by contracts called Special Service Agreements and shall be regulated by the Law on Obligations and a simplified recruitment procedure shall be applied". The Municipality has engaged 49 officials through special service agreements in which we have identified the following weaknesses:

- In 28 cases, the period of engagement of officials was longer than six months (as stipulated);
- In three cases, Municipality had not implemented any recruitment procedures in accordance with legal requirements; and
- For monthly payments to these officials was not attached any evidence or report, to verify that services have been delivered/received in line with the contract.

Risk

Identified weaknesses may result in lack of competition and poor quality of services provided. Due to lack of controls, Municipality gets exposed to the risk of unplanned increase of expenditures that may affect fulfilment of other defined objectives.

Recommendation 5

The Mayor should ensure that they take measures to discontinue the practice of concluding contracts without recruitment procedures, and their duration should be done in accordance with relevant legislation. If there is a need for additional employees in the Municipality (regular positions) to ensure that in the budget of the following years in the category of wages and salaries are included all salaries of necessary employees, and that all payments for their salaries go through the payroll system. In addition, payments for special service agreements are to be carried out only after securing sufficient evidence on provision of services.

3.4 Goods and Services and Utilities

The final budget for goods, services and utilities in 2017 was €1,012,652, out of which were spent €882,627 or 87%. Expenditures mainly relate to payments for utilities, travel, telecommunications, services, purchase of furniture and equipment, fuel, services of registration and insurance, maintenance etc.

The Municipality had planned 48 procurement activities, but had significantly exceeded this number by executing 67 activities. Some of the activities have not been planned mainly relate to minimal value contracts. Controls in this area have generally operated well. In all tested samples were assigned contract managers and the work completed was confirmed before each payment.

Recommendations

We have no recommendations in this area.

3.5 Subsidies and Transfers

The final budget for subsidies and transfers was €296,915, out of which in 2017 were spent €262,018 or 88% of the final budget. Expenditures mainly relate to support of cultural activities, sports or ad-hoc assistance.

Recommendations

We have no recommendations in this area.

3.6 Capital Investments

The final budget for capital investments was €2,706,603, out of which Municipality in 2017 had spent €2,070,342. They relate to infrastructure renovation, construction of buildings, asphaltting of roads, concreting of irrigation channels, various capital improvements etc.

The Municipality had planned 76 procurement activities, but had carried out 88 activities, or 12 more than planned. Differences have occurred as activities that were financed by other budget organizations have not been planned. In all cases, Municipality had confirmed the work delivered before making any payment, and had hired an external company to oversee the works.

Issue 6 – Entering into liabilities without available funds

Finding Municipality has started construction of 10 houses according to the project “Construction of Homes for the Homeless in the Municipality of Istog”, by exceeding the available budget of €95,000. The contract signed on 13/07/2017 specifies only the price per unit/house in the amount of €10,679 but does not the number of houses that should be constructed.

Risk Entering into liabilities without sufficient budget is in disagreement with the LPFMA and increases the risk of exposing the Municipality to penalties due to delays, whereby causing budget difficulties on the oncoming years.

Recommendation 6 The Mayor should enhance controls to ensure that the Municipality has sufficient funds prior to entering into contractual obligations, and requirements for Bill of Quantities should be specified according to the needs and in accordance with procurement rules.

Issue 7 – Deficiencies upon setting the criteria in procurement activities

Finding In the procurement activity “Oversight of capital projects”, in the contract notice dated 10/03/2017, Section III.2.4 Technical and Professional Capacity, one of the requirements was that the project manager to have three years of work experience. However, under the required evidence was not specified the type of evidence required to document the work experience, therefore, the committee during the evaluation of bids had accepted only the CV as evidence on work experience, without securing sufficient evidence to document work experience, and had signed the contract with the same. Consequently, the contract was entered into with an ineligible Economic Operator (EO) in terms of technical and professional requirements.

Risk Failure to specify documents to prove required work experience, and evaluating work experience solely based on a CV provided by the EO, poses a risk as staff engaged in the project may not have adequate professional experience and as a result can affect the quality of works carried out.

Recommendation 7 The Mayor should ensure that additional controls on the development of procurement activities. Initially the criteria set out must be clear, and then the Bid Evaluation Committee should make an objective assessment in accordance with them.

Issue 8 - Failure to comply with the procedure for confiscation of performance security

Finding In the procurement activity for construction of the local road “Selman Tahirsylaj” in village Lluga, the municipality had not confiscated the tender performance security from the EO who withdrew from bidding after the evaluation committee had recommended award of the contract to this EO. Performance security was in the amount of €3,000. This means that legal requirement stipulated under the Operational Guideline, Section 29.8 was not fulfilled, while the Municipality had not provided any justification on this.

Risk Identified deficiencies affect the reputation of the Municipality and may result in additional delays or expenses, due to non-application of legal measures towards bidders that are not serious.

Recommendation 8 The Mayor should ensure application of additional controls over the implementation of procedure for confiscation of performance security, in cases defined under the rules and the Operational Guidelines for Public Procurement.

Issue 9 - Signing contracts without budgeted funds for oncoming years

Finding In two cases the Municipality has signed contracts at the end of the year without budgeted funds for oncoming years. Contracts: “Asphalting of local road Selmon Tahirsyla, village Lluga” on 29/11/2017 with a dynamic plan of 60 days, and “Concreting of irrigation channel Vrell - Prigode” on 13/11/2017 with a dynamic plan of 50 working days. Budget Law requirements prohibit signing contracts at the end of the year for projects, expenses of which are expected to be incurred next year. Exceptions are made only when the budget for such project is also planned for future years.

Risk Contracts for projects that may not be completed in the current year and potentially incur unplanned expenses in the coming year, increase the risk of total project failure or increase expenses which cannot be covered.

Recommendation 9 The Mayor should ensure that the Municipality enters into contractual obligations in accordance with annual budgeted funds, and according to the rules. Adequate controls should operate prior to signing contracts, especially at the end-year period.

3.7 Common Issues on Goods and Services and Capital Investments

The following common issues relate to Goods and Services and Capital Investments:

Issue 10 - Failure to comply with legislation upon establishment of evaluation committees.

Finding The Municipality of Istog in the beginning of 2017 had approved a list of 20 staff members who were engaged as needed in various committees, whether for opening or evaluation of bids without a prior decision by the Chief Administrative Officer. Pursuant to Article 40 of Rules and Operational Guidelines of Public Procurement, the evaluation committee is established on case-by-case basis by the Chief Administrative Officer with a recommendation by the responsible procurement officer.

Furthermore, the number of members participating in evaluation committees should be odd and no less than three. In one case the evaluation committee consisted of four members which is in disagreement with the abovementioned rules.

Risk Failure to establish committees on case-by-case basis as required under the Rules and Operational Guidelines of Public Procurement poses a risk, as members assigned to respective committees may not be competent for the assigned task.

Recommendation 10 The Mayor should ensure that during the development of procurement activities are established respective committees on case-by-case basis with the decision of the Chief Administrative Officer, in accordance with the Rules and Operational Guidelines of Public Procurement.

Issue 11 - Payments carried out without sufficient evidence

Finding While testing payments we noticed that in the following two cases were carried out payments without sufficient evidence on provision of services:

- The payment in the amount of €638 for “Establishment of a Unified Address System in the Municipality of Istog” was carried out without proof on provision of services; and
- The payment in the amount of €15,000 for “Maintenance of Local Roads in the Municipality of Istog” was carried out based on the report prepared by the committee for executed works, according to which the company has covered the road with gravel in different locations of the Municipality, but is not specified which roads and the quantity of works executed.

Risk Carrying out payments without evidence or failure to specify works and services received increases the risk of carrying out payments without receiving the supply or in disagreement with the contract. This can also affect the budget.

Recommendation 11 The Mayor should strengthen controls over the processing of payments to ensure that payments are carried out only after receiving sufficient evidence on delivered works/services.

3.8 Capital and Non-Capital Assets

According to the KFMIS accounting register, the value of net assets (over €1,000) is €16,147,730, while the value of non-capital assets (under €1,000) is €137,841.

Issue 12 - Deficiencies in assets management

Finding The Regulation on assets management stipulates that inventorying report is to be produced before preparation of the AFS, so that the inventory committee has the possibility of comparing the inventorying register with registers of non-financial assets. At the end of the year the Municipality had established the inventorying committee, but the committee had not managed to complete this process before the preparation and submission of the AFS.

Risk Inadequate engagement on updating assets register results in incomplete information on assets owned. This exposes assets to the risk of misuse, loss, or alienation, and at the same time results in incorrect presentation of assets in the AFS.

Recommendation 12 The Mayor should ensure that the committee completes the inventorying report before the preparation of AFS. The report should include comparisons of assets physical condition with registers, and if there are differences, they should be presented in assets register and in the accounting register.

3.9 Receivables

Municipality of Istog has presented Accounts Receivable in the amount of €1,189,600, which relates to: property tax €922,000, construction permits €55,630, business activity charges €175,000, charges for alcoholic beverages €8,000, and from temporary leases of municipal property in the amount of €28,970.

Recommendations

We have no recommendations in this area.

3.10 Outstanding Liabilities

The statement of liabilities not paid to suppliers at the end of 2017 was €122,635. These liabilities are carried forward to be paid in 2018. The entry into the liabilities was mainly due to poor controls in terms of reporting and payments and liabilities.

Issue 13 - Delays in paying invoices and failure to report liabilities

Finding The Municipality was late in carrying out seven payments to suppliers for invoices/liabilities that amounted to €12,772. Under the Law on Public Financial Management, Article 39, is established the deadline for carrying the payment with 30 days from the receipt of invoice.

In addition, Municipality of Istog during 2017 has not reported any outstanding liabilities to the MoF, as required under the Regulation no. 02/2013, which obligates the Municipality to report monthly on received and outstanding invoices.

Risk Inadequate controls over the management and reporting of liabilities increases the risk of entering into liabilities without sufficient budget, or even to face justice bodies, whereby incurring additional costs and budget difficulties for the oncoming years.

Recommendation 13 The Mayor should ensure that all payments are carried out within 30 days from the receipt of invoices. Furthermore, to establish an effective system under which all outstanding invoices are accurately and thoroughly reported on a monthly basis to the MoF, and to disclose them correctly in the AFS at every end of the year.

4 Progress in implementing recommendations

Our Audit Report on the 2016 AFS of Municipality of Istog resulted in 16 key recommendations. Municipality of Istog had prepared an Action Plan stating how all recommendations will be implemented. However, sufficient actions were not taken, as the Action Plan was not entirely implemented and the same deficiencies are repeated in some areas.

At the end of our 2017 audit, only four recommendations have been fully implemented; four were in process; and eight have not been addressed yet. In addition, from the year 2015, 13 recommendations were carried forward, out of which one was implemented, two were in the process, and ten have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II.

Issue 14 – Low level of implementation of prior years’ recommendations

Finding Even though the Municipality has drafted the action plan on time, only a part of prior year recommendations has been implemented as Municipality has not followed any formal processes to manage and monitor the manner of implementation of recommendations given by the Auditor General. Municipality’s management does not apply any responsibility measures for failure to implement recommendations.

Risk Failure to implement recommendations poses a risk of having same deficiencies, which can lead to weaknesses in management and reporting of expenditures.

Recommendation 14 The Mayor should ensure that implementation of the Action Plan is constantly monitored and reported monthly or quarterly on the progress made in this regard. Recommendations that are not implemented according to the timeframe should be revised within a short period by the Mayor, and take proactive actions against obstacles encountered upon implementation.

5 Good Governance

Introduction

Good Governance implies basic principles of accountability, effectiveness of controls, risk management, independence of internal audit, coordination of NAO with internal audit and good governance with public assets.

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 level of compliance with FMC requirements by Budget Organizations is monitored by the self-assessment checklists completed by all BOs, which are submitted at the end of the year to the Ministry of Finance.

Specific areas of our governance-related reviews have been the accountability and risk management process, while the other components are handled within the chapters or subchapters above.

Overall Governance Conclusion

Municipality of Istog during 2017 has made a number of improvements in governance, but there are still a number of areas where further improvement is needed. However, our audit has highlighted existence of some weaknesses such as lack of a strategic plan for risk management, inadequate monitoring over the complete implementation of NAO and IAU recommendations, lack of a system for risk management, and poor managerial reporting.

The Municipality of Istog had drafted the strategy for local economic development for the period 2017-2020, as well as urban plans, emergency operational plan, and the strategic anti-corruption plan.

5.1 Internal Audit System

The Internal Audit Unit (IAU) operates with one auditor, the Unit Director. The impact of Internal Audit products should be judged by the importance that the management gives to addressing of recommendations, as well as by the support provided by an effective Audit Committee. The IAU has drafted the Strategic Plan, and the Annual Work Plan, while the Audit Committee (AC) has held regular meetings during 2017. Out of four audits planned, three were completed during 2017. Audits of IAU have covered assets management (scope 2016), management of health department (scope 2016/2017) and property tax management for 2017.

Issue 15 - Limited Functioning of the IAU and AC

Finding There are a number of weaknesses related to current operations of the IAU, such as:

- Audited units have not drafted plans to implement IAU recommendations, due to which has resulted in a low level of implementation of recommendations. Out of 21 recommendations given, 6 were implemented, 8 were in the process of implementation, while the rest were not addressed. This shows lack of focus by the management to ensure that recommendations are implemented on time by the Municipality; and
- Audit Committee has held four meetings wherein were discussed reports of the IAU and the NAO are. However, the AC was not sufficiently effective in fulfilling its mandate by overseeing the results of the IAU, and in providing contribution to implementation of internal and external audit recommendations by the management.

Risk Failure to implement recommendations reduces the efficiency and the impact of internal audit services on improvement of overall governance.

Recommendation 15 The Mayor, in cooperation with AC and IAU, should take specific actions to draft an action plan for implementation of recommendations and take all actions against administrative units to which recommendations are addressed, so that they show maximum commitment in taking corrective measures in areas where weaknesses have been identified.

5.2 Management Reporting, Accountability and Risk Management

In order to have a proper planning, supervise the activities on a regular basis and allow effective decision-making, the Management needs to have regular reports. Accountability as a process is the acceptance of responsibilities, holding persons into account for their actions and disclosing results in a transparent way. Whereas, risk management is a process related to identification, analysis, evaluation and actions/measures taken by the Management to control and respond to risks threatening the Organization.

Although, a range of internal controls are applied by Management to ensure that systems and operate as intended, we have noticed that the measures applied are weak and ineffective and therefore do not provide an effective and timely response to the identified operational problems.

Issue 16 – Weaknesses in managerial controls and risk management

Finding Our review of managerial controls implemented in Municipality’s main financial system has highlighted poor financial reporting over the expenditures and revenues, as well as incomplete analysis over the service delivery. Despite the fact that accountability and communication lines were functional through regular weekly meetings, current reporting format does not provide a basis for effective internal controls as reporting in writing to the senior management is only per request and not on regular basis. Due to poor controls, weaknesses were noticed in the area of procurement, payment of expenses, assets recording and reporting of liabilities.

Municipality of Istog does not have written policies and procedures for managing risks. There is no risk register drafted according to FMC requirements, wherein would be identified potential risks against objectives, determined their manner of management and units responsible for taking necessary actions.

Risk Poor accountability requirements and poor quality financial reporting reduce the effectiveness of financial management. This results in weaknesses within the budget process and reduces Management’s ability to respond to financial challenges in time. It also reduces the effect of budget controls and increases the risk of improper spending. Consequently, this may also result in providing poor quality services.

Recommendation 16 The Mayor should ensure that a review has been carried through to determine the form of financial and operational reporting to senior management. Furthermore, in order to reduce the impact of risks to acceptable levels, the Organization should draft a risk register with all appropriate measures/actions to put the exposed threats under control.

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

(extract from ISSAI 200)

Form of opinion

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

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

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

Modifications to the opinion in the auditor's report

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

Determining the type of modification to the auditor's opinion

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

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

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

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

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

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

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

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

158. An Emphasis of Matter paragraph should:

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

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

Annex II: Progress in implementing recommendations of previous and earlier years

Audit Component	Recommendation carried forward from 2015	Implemented during 2016/2017	Under implementation during 2017	Not implemented
1.5 Recommendations	The Mayor should ensure that effective processes are in place to confirm that the 2016 AFS production plan formally addresses all audit issues raised, including complete recording of all assets. This should also include the review of the draft AFS by the management, with a special focus on areas of high risk/or areas where errors have been identified.			No measures taken
2.3 Prior Year Recommendations	The Mayor should strengthen control measures and responsibilities towards officials who are responsible for complete implementation of recommendations, so that the actions foreseen under the Action Plan are implemented, particularly in the areas identified with the greatest degree of risk and within the limits set.			No measures taken
2.4 Self-Assessment Checklist	The Mayor should ensure that governance processes are accompanied by strategic plans, risk management, and implementation of procedures, in order to measure results against objectives. In addition, reporting and communication will improve management's ability to respond to potential challenges on time.			No measures taken

2.5.1 Risk Assessment	The Mayor should ensure establishment of formal procedures to manage risks in the organisation, so that necessary actions are determined and undertaken should they occur, and to monitor them systematically. The first step towards this is drafting of the risks registry.			No measures taken
2.5.2 Management Reporting	The Mayor should ensure that a review is implemented to determine the format of financial reporting to senior management, which is required to support effective business management and to ensure that an appropriate solution is in place.			No measures taken
2.6 Internal Audit System	The Mayor should discuss an action plan with other management levels, assign staff responsible, and determine deadlines to address recommendations given by the internal audit. In addition, should be established process for monitoring of progress. When identified issues that need handling, the IAU are should focus more on current year activities, by giving a priority to areas where the risk level is considered high.			No measures taken
3.4 Procurement	The Mayor should review why procurement requirements were not implemented in the abovementioned cases and apply additional controls to ensure that such situations are not repeated in the future.		There was progress, but further action is needed to completely eliminate procurement weaknesses.	

3.5 Expenditure not related to Procurement	The Mayor should ensure that upon co-financing in the future, it will be an active and equal party in terms of follow up, implementation and oversight of these projects. Practices such financing and payments made under these agreements should be stopped, and instead insist that all payments are made only after the receipt of services and based on invoices and to the progress of the agreements, and no prepayments., further, contracts for special services are used for specific purposes where really no shortage of staff as well as their duration do not be over 6 months as defined by the law. We suggest that such practices are not repeated.		Partially implemented, the issue of engaging staff with special services contracts remains to be addressed.	
3.5.1 Remunerations (Wages and Salaries)	The Mayor has to look into this issue and determine why have these irregularities occurred in the process, and have been repeated for years, and to ensure that in the payroll system will not be processed payments based on fictive contracts.	Yes		
3.6 Own source revenues	The Mayor should ensure that verification of municipal property is done as foreseen under the law, so that all potential changes of properties that are valuable to the taxable base are integrated in the database. Furthermore, additional actions are undertaken to ensure that deductions of €10,000 are applied in line with Article 9 of the Law on Taxes on Immovable.			No measures taken
3.6 Own source revenues	The Mayor should ensure that public auctions are organised when leasing municipal property, in order to have an open and transparent process, and to increase mechanisms and exercise constant monitoring over the use of public spaces, so that they are not used prior to meeting obligations in line with the municipal Regulation.			No measures taken

3.7.1 Capital and Non Capital Assets	The Mayor should ensure drafting of an internal guideline on assets management wherein roles and duties of certain officials who have to contribute to preparation of data on assets that need to be recorded are clarified, and then all assets are correctly presented in the AFS. To ensure that adequate controls are applied to ensure that vehicles are used for official purposes.			No measures taken
3.7.3 Handling of debts	The Mayor should ensure that the reporting of outstanding liabilities is done in the Treasury on monthly basis and are undertaken measures so that that invoices are paid within the legal deadlines.			No measures taken
Audit Component	Recommendation carried forward from 2016	Implemented during 2017	Under implementation during 2017	Not implemented
1.3 Recommendations for the first part of the report	The Mayor should ensure that an analysis is undertaken to determine the causes of the emphasis of matter. Proper actions should be taken to have all assets registered in the respective assets registers and to remove current errors in the accounting registers in order to ensure that assets are correctly recorded and accounts receivable fully disclosed.			No measures taken
2.1 Progress in the Implementation of Prior Year Recommendations	The Mayor should ensure that a strengthened process of accountability towards the staff in charge with the implementation of recommendations, with deadlines and priorities set in the action plan is implemented. Implementation progress should be monitored systematically and where setbacks are identified adequate measures should be taken.			No measures taken

2.2 Self-Assessment Checklist of FMC components	The Mayor should ensure that a review of the processes for completing the self-assessment checklist and proactively addressing areas of weaknesses is implemented. Internal Audit should be involved in the final review process to confirm the accuracy of the return and to ensure supporting documentation.		The Municipality had not taken measures yet to address weaknesses identified in the self-assessment questionnaire.	
2.3.1 Setting of Strategic Objectives	The Mayor should timely draft strategic plans on the development of the Municipality, with clear strategic objectives set and propose them to the Municipal Assembly for approval. He should also ensure the oversight and measurement of the achievement of such objectives on regular basis.		The regional development strategy has not yet been approved in the municipal assembly.	
2.3.2 Management Reporting and Accountability	The Mayor should ensure that a review is implemented to determine the format of financial and operational reporting to senior management which is required to support effective business management.			No measures taken
2.4 Internal Audit System	The Mayor and the Director of IAU should work together to provide for sufficient reviews on current year financial systems. In the coming years, fulfilment of activities planned by IAU should be monitored on an ongoing basis and actions should be taken in order to timely address departures from the plan.			No measures taken
3.1 Budget Planning and Execution	The Mayor should ensure that budget performance is systematically monitored on a monthly basis and that this review identifies and addresses barriers to planned levels of budget execution. Where initial or reviewed budget assumptions are found to be incorrect this should be fully reflected in the final budget position.		Due to lack of budget review in 2017, initial budget estimates, although they were inaccurate, could not have been changed.	

3.1.1 Revenues	The Mayor should ensure that municipal property is leased according to the Regulation no.23/2013 on Determination of Procedures on the Allocation for Use and Exchange of Immovable Property of Municipality.			No measures taken
3.1.1 Revenues	The Mayor should ensure that officers in charge consider all applications in time and issue respective decisions within the statutory deadlines.	Yes		
3.1.1 Revenues	The Mayor should ensure that municipal property is verified as stipulated in the administrative instruction in order to have all eventual changes on properties integrated in the database, which is valid for the taxable basis.			No measures taken
3.1.3 Goods and Services and Utilities	The Mayor should ensure that the procurement plan is prepared based on real needs, execution is made in line with planning and that needed funds to execute contracts are committed before the contracts are signed.	Yes		
3.1.3 Goods and Services and Utilities	The Mayor should ensure that the law is adhered to and that contracts are entered into in line with the requirements in the Tender Dossier.	Yes		
3.1.5 Capital Investments	The Mayor should ensure that the construction book is applied when it comes to future progress payments for ongoing or new projects and that it is reconciled with the progress payments in order to verify the accuracy of executed works and amounts of payments. It should be made clear to project managers that future activities should be in line with the Law no.04/L-110 on Construction and the AI no.15/2013 on Conditions for Maintaining the Construction Diary and Construction Book issued by MESP.	Yes		

3.1.6 Common Issues on Goods and Services and Capital Investments	The Mayor should ensure that during the intimal budget planning, expenditures are planned, incurred and recorded under adequate economic categories according to the Chart of Accounts.			No measures taken
3.2.1 Capital and Non Capital Assets	The Mayor should ensure that assets registers are complete and accurate and that concrete actions are taken for the weaknesses identified during the stocktaking in order to improve them according to the Regulation on Assets Management		In the assets register are not registered yet 1,540 municipal land parcels, and the assets register under €1,000 (e-assets) has not yet been updated with data of previous years' assets in the Health and Education sector, and the inventorying was not carried out at the right time.	
3.3 Outstanding Liabilities	The Mayor should ensure that received invoices are paid within the foreseen statutory deadline and that outstanding liabilities are reported according to the timelines set in the financial rules.			No measures taken

Annex III: Letter of confirmation


REPUBLIKA E KOSOVËS KOMUNA E ISTOGUT
REPUBLIKA KOSOVO OPŠTINA ISTOK
DREJTORIA E ADMINISTRATËS PËRGJITHSHME
UPRAVA OPŠTE ADMINISTRACIJE
Uales-lizazna
Nr: 01-016-22970 Data 10.05.2018
Br: Datum
ISTOG-ISTOK


Komuna e Istogut
LETËR E KONFIRMIMIT

Për pajtueshmërinë me të gjeturat e Auditorit të ZKA, në Raportin e auditimit për vitin
2017 dhe për zbatimin e rekomandimeve

Për: Zyrën Kombëtare të Auditimit

Të nderuar,

Përmes kësaj shkrese, konfirmoj se:

- Kam pranuar draft raportin e Zyrës Kombëtare të Auditimit për auditimin e Raportit/Pasqyrave Financiare të Komunës së Istogut, për vitin e përfunduar më 31 dhjetor 2017 (në tekstin e mëtejme "Raporti");
- Pajtohem me të gjeturat dhe rekomandimet dhe nuk kam ndonjë koment për përmbajtjen e Raportit; si dhe
- Brenda 30 ditëve nga pranimi i Raportit final, do t'ju dorëzoj një plan të veprimit për zbatimin e rekomandimeve, i cili do të përfshijë afatet kohore dhe stafin përgjegjës për implementimin e tyre.


z. Haki Rugova
Kryetar i Komunës,


Data: 10.05.2018, Istog