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AUDIT REPORT

**ON THE FINANCIAL STATEMENTS OF
THE MUNICIPALITY OF MAMUSHA
FOR THE YEAR ENDED 31 DECEMBER 2013**

Pristina, June 2014

*The Municipality has not prepared financial statements in the English language. The financial statements are attached to our report in the Albanian language.

KPMG has carried out an audit of the Annual Financial Statements ('AFS') of the Municipality of Mamusha ("Municipality"), on behalf of the Office of the Auditor General of Kosovo, for the year ended 31 December 2013.

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

The OAG's 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 OAG directly promote accountability as they provide a base for holding managers' of individual budget organisations to account.

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Executive Summary

Introduction

KPMG has carried out an audit of the Annual Financial Statements ('AFS') of the Municipality of Mamusha (the 'Municipality') for the year ended 31 December 2013, on behalf of the Office of the Auditor General.

This report summarises the key findings from our audit of the 2013 Annual Financial Statements (AFS), which determine the Audit Opinion. We would like to thank the Mayor and his team for their assistance during the audit process.

The audit of the 2013 financial statements was conducted in accordance with the International Organisation of Supreme Audit Institutions (INTOSAI) Fundamental Auditing Principles and Guidelines. Our approach included such tests and procedures as we deemed necessary to form an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated October 2013.

Our audit focused on:

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

The level of work undertaken by us 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.

Our opinion is included in Part 2.1 of this report.

Note: The opinion reflects the audit findings and conclusions highlighted in this report.

Overall Conclusion

Based on the detailed sections of this report, our overall conclusion is:

The Management of the Municipality has designed and implemented an internal control system. However, certain controls over key areas of the financial reporting and management were not implemented and operating effectively. In particular, we identified the following weaknesses:

- During the last years, the Municipality has only partially addressed our recommendations in relation to Article 16 'Disclosure of assets' and payments from third parties and as a result, this area continues to represent a significant risk. Due to the nature of the underlying records and lack of supporting documentation, uncertainties exist with regard to the ownership rights, completeness and valuation of the property, plant and equipment;
- Furthermore, the Municipality has not addressed our other recommendations from previous years. The Municipality does not have in place a robust process that would ensure a timely and complete implementation of our recommendations;
- Actual own source revenues represent 67% of the budget for the year 2013, and decreased by 7% when compared to the revenues for the year 2012. The budget execution is one of the main areas where more improvements are necessary;
- The Municipality does not yet have an automatic billing system for all types of own source revenues and receivables related to them;
- Non-compliances identified in the procurement process related to wrong classification of expenses and to excess of budget limits.
- Free Balance does not ensure completeness of the information required for financial reporting purposes and it cannot solely be used to produce comprehensive financial statements. Although the majority of requirements for presentation of the AFS were addressed, there were a number of omissions and inaccuracies in the draft AFS provided to us. Only some of these were adjusted in preparing the final version of the AFS, while others remain unadjusted, as detailed in part 2.3 of this document;
- The Municipality has not established an Audit Committee and an Internal Audit Unit.

Our key recommendations are that the Mayor should:

- Analyse the reasons for the uncertainties in relation to property, plant and equipment and identify the actions required to address such matter, in order to ensure a proper presentation of the properties in 2014. The required timely support from an internally established Assets Inventory Committee may be considered;
 - Regularly monitor the budget performance on a monthly basis and identify and address barriers to the planned levels of budget execution. Where the initial budget assumptions are found to be inaccurate, this should be addressed in the final budget. Ensure that the plan for own source revenues is realistic and corresponds to the opportunities to collect revenues. Furthermore, the Mayor should ensure that all necessary measures are taken to collect these revenues;
 - Ensure that an updated action plan is prepared and reviewed on a quarterly basis and clearly sets out the timeframe for addressing our recommendations, which includes the identification of the responsible officers/units/entities, and initial focus on the most significant areas;
 - Improve the billing and accounting systems in order to ensure safe, efficient and effective controls on billing and revenue. Improvement of the procedures related to such systems would enable management to monitor and manage significant risks, and to ensure that decisions related to budgeting, planning and collection of revenues are properly carried out;
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- Perform a detailed assessment of the procurement process, and the related reporting and classification of expenses and controls over them, in order to identify weaknesses and to determine actions that should be taken to address such weaknesses;
 - Ensure an automatic and effective process for the recording and reporting of disclosures in the AFS for 2014, which formally incorporates the management review of the draft financial statements with specific focus on areas considered as high risk of error and/or areas where errors have been identified in previous years; and
 - Establish an Internal Audit Department and an Audit Committee that is independent from the management and ensure that appropriate policies and procedures are compiled to ensure a high standard of corporate governance, and implement a risk based internal audit programme for the year 2014, which provides assurance to the management in relation to the effective operations or key financial systems.

1 Audit Scope and methodology

It is the responsibility of the Municipality to prepare financial statements in accordance with the International Public Sector Accounting Standards (IPSAS) for 'Financial Reporting under the Cash Basis for Accounting' and other specific requirements. We are 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 audit 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 our review. The Mayor's responses are in Annex III. An assessment of the Management Responses to recommendations made in 2012 is in Annex II.

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 as 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 accuracy of the information recorded in the financial statements. We also consider the Declaration made by the CEO (the 'Mayor') 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 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.

We have determined an unmodified opinion with an 'Other matter' paragraph because the Municipality has not addressed all our recommendations in relation to properties disclosed in the AFS. We identified a number of immaterial errors in the AFS and the reporting requirements were met. There were no major exceptions noted in relation to the other external reporting requirements. However, the 'Other matter' paragraph indicates that the Declaration referred to above was not correct in all respects.

The terminology used in the current year for different types of opinions changed with reference to ISSAI 200. In the current year, we have used the 'unmodified opinion' terminology, instead of the 'unqualified opinion' used in the prior year. For further details on the types of audit opinions, please refer to the Annex 'Explanation of the different types of opinion applied'.

2.1 Audit Opinion

To the Municipality of Mamusha

Pristina, 6 June 2014

We have audited the accompanying financial statements of Municipality of Mamusha ('the Municipality'), which comprise the statement of cash receipts and payments for the year ended 31 December 2013, a comparison of budget and actual amounts, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards ('IPSAS') for 'Financial Reporting under the Cash Basis of Accounting' and with the Regulation MoF- No. 03/2013 'On Annual Financial Statements of Budget Organizations'. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the International Organization of Supreme Audit Institutions (INTOSAI) Fundamental Auditing Principles and Guidelines. Those 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 misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, internal control relevant to the entity's preparation and presentation of financial statements is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the financial statements of the Municipality for the year ended 31 December 2013 are prepared, in all material respects, in accordance with IPSAS for 'Financial Reporting under the Cash Basis of Accounting' and with the Regulation MoF- No. 03/2013 'On Annual Financial Statements of Budget Organizations'.

Other Matter

Without qualifying our opinion, we draw attention to the following:

- Article 16 comprises disclosures of nonfinancial capital and noncapital assets. Due to lack of ownership documentation for certain properties, uncertainties exist with regard to the ownership rights of the Municipality. In addition, due to lack of supporting documentation for the measurement of a significant part of these assets, the Municipality sought to measure some of the main properties only, at fair value based on a valuation performed by an internally established committee.
- 'Payments from third parties' presented in Article 12 include a total of EUR 126 thousand that represents investments financed by the Ministries of Kosovo, rather than from third parties. In addition, the formal transfer of ownership has not yet been obtained for a significant part of the assets that were presented as 'Payments from third parties'.

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2.2 Significant risks to the Annual Financial Statements

Description

During the audit, we identified a risk in relation to the presentation of Article 16 Disclosure of Assets and of payments from third parties.

The Risk reflects the following:

- Uncertainties regarding ownership rights of the Municipality or various other Kosovo Government Agencies.
- The disclosure of assets is not complete, because not all property, plant and equipment were included in the valuation.
- The Municipality has not received formal evidence of the transfer and ownership of investments financed by third parties, and of the amounts that should be recorded and presented in the financial statements.

In addition, we identified a risk in relation to other compliance issues (please see Issue 2 below).

The risk was identified and occurred.

Identified Risk

Our approach so far reflects our audit response for the period ended 31 December 2013, as it is also explained in the audit planning memorandum. We draw attention to the following issues:

Issue 1 - Article 16 'Disclosure of assets' and Payments received from third parties.

Finding

- Article 16 Disclosure of Assets: For certain properties, there are uncertainties regarding ownership rights of the Municipality or various other Kosovo Government Agencies and lack of supporting ownership documentation. In addition, due to lack of supporting documentation for the measurement of a significant part of these assets, the Municipality sought to measure them at fair value based on a valuation of the main properties performed by an internally established committee. The difference between the total amount presented in Article 16 'Disclosure of assets' for capital and noncapital assets, for the year ended 31 December 2013 and the total at 31 December 2012, is different by EUR 617 thousands from the additions of properties disclosed in Article 12.
- Payments from third parties: Payments received from third parties of EUR 186 thousand that are presented in financial statements in 2013, comprise assets financed by the ministries with a total value of EUR 126 thousand, for which there is no evidence of transfer to the Municipality, and assets of EUR 32 thousand financed by USAID, that are not supported by any documentation. The corresponding assets are not presented in Article 16 'Disclosure of Assets' since the Municipality does not have any formal document from third parties to support the transfer of these assets to the Municipality.

Risk

Due to lack of ownership documentation there are uncertainties regarding ownership rights of the Municipality or various other Kosovo Government Agencies. As a result the Municipality may face difficulties in utilising such properties in the future. In addition, the disclosure of assets is not complete, because not all property, plant and equipment were included in the valuation. Such deficiencies may result in significant values not included in the AFS, or in the wrong value of assets being presented, and in the inability of the management to control and exploit the resources in favour of the Municipality.

Audit Response

We considered the Municipality's internal controls and other processes related to the presentation of property and payments from third parties in the FS. We advised the Municipality on the additional actions required to ensure an effective process of recording and reporting properties in the financial statements for 2013.

In addition, we audited a sample of expenditures which represent additions to property for the period, to determine that the expected capitalization approach was applied, proper classification and disclosure of assets was made, and we have informed the management on the results of such work.

Issue 2 - Other Compliance issues

Finding

The following compliance issues were identified:

- The primary reliable source of information for the preparation of financial statements is Free Balance, which is not being used to record income from fines, payments from third parties and outstanding invoices.
- The Municipality has not implemented a comprehensive and automated billing system.
- Non-compliances identified in the procurement process related to wrong classification of expenses and to excess of budget limits.
- The Municipality does not have in place any formal process that would ensure complete, adequate and reliable information for the legal cases.
- The Municipality did not prepare and submitted Financial Statements in the Serbian language.

Risk

- Free Balance does not ensure completeness of the information required for financial reporting purposes and it cannot solely be used to produce comprehensive financial statements.
- There is uncertainty regarding completeness of both receivables and revenues that the Municipality can earn, and their ability to prepare a reliable and accurate budget, to report an accurate collection ratio, and monitor the collection of the own source revenues on a timely basis.
- Wrong classification of expenses may result in misstatements in the financial statements, and in the reporting for budgeting purposes. It may also lead to wrong interpretations of the performance and of the budget execution.
- Although the Municipality may be involved in some minor legal cases, lack of formal identification procedures may impair the ability to forecast and manage any required future cash outflows, as well as the ability to report and record provisions and contingent liabilities regarding such cases.
- Lack of financial statements in the Serbian language limits the use of these statements by the readers and such practice is not in compliance with the legislation.

Audit Response

We considered the Municipality's internal controls and processes related to recording and presentation in the FS of those disclosures that are not reported under the Cash Basis Accounting and are not recorded in Free Balance. Such disclosures include income from fines, payments from third parties, receivables and contingent liabilities.

We requested from the Municipality the preparation of the AFS in the Serbian language and recommended additional actions that are required from the Municipality, to ensure an automatic and effective process for the recording and reporting of disclosures in the AFS for 2013.

We considered the Municipality's internal controls and processes related to procurement, recording and reporting of assets and other expenses. We reported to the Municipality our findings and recommended that measures are taken to comply with the requirements of the law.

We recommended the Municipality to implement a formal process that would ensure complete, adequate and reliable information for recording provisions and contingent liabilities.

2.3 Compliance with AFS reporting requirements

Description

The requirements of the IPSAS 'Financial Reporting under the Cash Basis of Accounting' and of the Financial Regulation No. 03/2013 have only partially been met in preparing the financial statements. We considered the following:

- Compliance with FR no. 03/2013;
- Requirements of LPFMA no. 03/L-048;
- The time frame for submission to the MoF;
- The requirement for the AFS to be signed by the CEO (the 'Mayor') and the CFO;
- The requirement to prepare the AFS in hard and electronic copies; and
- The submission of quarterly reports to the Municipal Assembly and the MoF.

As reported in our Audit Memorandum in December 2013, certain discrepancies were identified in the financial statements for the nine-month period ended 30 September 2013. Information presented in Article 10 did not agree with the notes detailing expenses and own source revenues. The expenses did not agree with totals reported in the Free Balance for an amount of EUR 34 thousand and revenues did not agree with Article 9 for an amount of EUR 30 thousand.

Certain adjustments were made to the annual financial statements and we also made other suggestions to improve the disclosures and to ensure completeness of such disclosures. Our findings are shown below.

Finding

The primary reliable source of information for the preparation of financial statements is Free Balance, which is not being used to record and report all disclosures that are not prepared under the Cash Basis Accounting. Such disclosures include income from fines, payments from third parties, receivables and contingent liabilities.

- Several roundings or small differences were identified in the notes to the financial statements and certain formats could be further improved to ensure a better presentation of financial statements.

The Municipality did not prepare reports in the Serbian language.

Risk

Free Balance does not ensure completeness of the information required for financial reporting purposes and cannot solely be used to generate comprehensive financial statements.

Lack of required disclosures, or disclosures that lack clarity limit the ability of the readers to use these financial statements, may lead to misrepresentations, and do not ensure compliance with the Financial Rule 03/2013.

Lack of financial statements in the Serbian language, may limit the use of these financial statements by the readers and such practice is not in compliance with the Financial Rule 03/2013.

Recommendation

We recommend the Mayor ensures that the preparation of the annual financial statements includes procedures and tools that are designed to ensure that the required information is recorded, processed, summarized and appropriately reported in the financial statements. We also recommend the Municipality prepares financial statements in the Serbian language.

Information on payments from third parties, receivables and contingent liabilities should be regularly updated and reviewed to ensure accuracy and completeness of such disclosures in the financial statements.

2.4 Compliance with other external reporting requirements

Description

In addition to the preparation of the AFS, the Municipality is required to comply with external reporting requirements, including the following:

- Budget Request;
- Quarterly reports, including nine-months financial statements;
- Operating Reports (performance reports), if any;
- The draft, timely procurement plan; and
- Action Plan on implementing recommendations, included in the annual financial statements of the Municipality.

No major exceptions were identified regarding the compliance with current external reporting requirements and the budget process.

3 Prior Year Recommendations

Overall conclusion

From the acceptance of our recommendations for the year 2012 in July 2013, only some actions have been taken to address the concerns raised. It is important that the Municipality takes proactive actions to ensure the improvement of key areas of financial management and control.

Description

Our Audit Report on the AFS of Municipality for 2012 resulted in nine key recommendations. The Municipality has prepared an Action Plan stating how all recommendations will be addressed. However, the specified period was not entirely met.

At the end of our audit for 2013, nine recommendations have not been addressed yet. For a thorough description of the recommendations and how they are addressed, see Annex II.

Issue - Addressing prior year recommendations - High Priority

Finding

None of the recommendations from last year were addressed because the Municipality does not have in place a formal process to manage and monitor the implementation of our recommendations.

Risk

Continuous weaknesses of internal controls over the key financial systems have resulted in:

- The budget not being met;
- Delays in procurement practices and their implementation, and budget execution;
- Delays in improving controls over the revenues and their collection; and
- Omissions or inaccurate disclosures of the properties of the Municipality and of payments from third parties in the financial statements.

Recommendation

The Mayor should ensure that a reviewed action plan determines the exact timelines to address the recommendations, identifies responsible staff members and initially focuses on the most important areas.

4 Financial Management and Control

4.1 Overall Conclusion

Our audit approach is focused on understanding and evaluating the actions taken by the management to ensure an effective financial management and control, and on the results of these actions. For individual financial systems we seek to identify the level at which actual controls operate. This may, for example, be the monitoring activity undertaken by senior management or lower level operational controls. We consider whether controls are well designed, have been implemented as planned and operate effectively. This requires an assessment of the structures, processes and responsibilities introduced by the management including the role of the Internal Audit and the Audit Committee.

Actual own source revenues represent 67% of the budget for the year 2013, and decreased by 7% when compared to the revenues for the year 2012. The low budget execution is one of the main areas where more improvements are necessary.

4.2 Good Governance

Description

No major exceptions noted.

Recommendation

We have no recommendation in this area.

4.3 Budget Planning and Execution

Description

In 2013, the budget execution for expenses represents 93% of the total budget. This represents a decrease of 1% when compared to the execution in the year 2012. The low execution when compared to the final budget is mainly due to capital investments.

Actual own source revenues represent 67% of the budget for the year 2013, and decreased by 7% when compared to the revenues for the year 2012.

The table below presents the initial and the revised budget of the Municipality, the sources of revenues and the funds spent by economic category:

Table 1. Source of budgetary funds - actual versus budget (in €'000)

Description	Initial budget 2013	Final Annual Budget ¹ 2013	2013 Annual Actual	2012 Annual Actual	2011 Annual Actual
Government Grant	1,004	1,004	973	1,003	973
Own source revenues transferred from the previous year ²	-	66	58	48	-
Own Source Revenues ³	60	60	19	6	6
Internal Donations	-	1	1	-	-
Donacionet e jashtme	-	1	-	-	-
Source of funds	1,064	1,132	1,051	1,057	979

Table 2: Funds spent by economic category - actual versus budget (in '000 €)

Description	Initial Budget 2013	Final Budget 2013	2013 Annual Actual	2012 Annual Actual	2011 Annual Actual
Wages and Salaries	708	709	682	694	636
Goods and Services	96	97	94	160	85
Utilities	22	22	22	23	21
Subsidies and Transfers	3	3	3	3	1
Capital Investments	235	301	250	177	236
Total expenses	1,064	1,132	1,051	1,057	979

Table 3: Own source revenues - actual versus budget (in €'000)

Description	Initial Budget 2013	Final Budget 2013	2013 Annual Actual	2012 Annual Actual	2011 Annual Actual
Own Source Revenues ⁴	60	60	40	43	42

- The Budget execution for capital investments for the year 2013 was 83% compared to the final budget for the year 2013. Low executions are also reported for other categories such as wages and salaries and goods and services. The utilization of funds for 2013 decreased by 1% when compared to the year 2012.
- Actual own source revenues represent 67% of the budget for the year 2013, and decreased by 7% when compared to the revenues for the year 2012. The realization of own source revenues in 2012 was 74% only, compared to the budget for that year.

¹ Final Budget - budget approved by the Assembly and continuously adjusted by the Ministry of Finance.

² Own source revenues of the Municipality not spent in the previous year and transferred to the current year.

³ A Portion of the receipts planned and collected for the Kosovo Budget in the current year, and used by the Municipality to finance its budgeted expenses.

⁴ Own Source Revenues collected in 2013.

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- The collection of own source revenues from tax on property for the year 2013, reported in the Free Balance represent only 65% of the total billed for the period. We do not have information to breakdown the collections into those related to invoices issued in 2013, or in previous years.
 - At 31 December 2013, in the financial statements of the Municipality are reported receivables for tax on property of EUR 80 thousand.

Because of the lack of billing systems for other types of revenues, we are not able to calculate collection ratios for those revenues.

Issue - Budget Execution - High Priority

Finding

Actual own source revenues represent 67% of the budget for the year 2013, and decreased by 7% when compared to the revenues for the year 2012. Meanwhile, the budget execution was 93% of the final budget. Such execution represents a decrease of 1% when compared to the amounts reported in the year 2012.

Risk

Inadequate budget planning and a low budget execution and realisation levels may result in failure to meet the objectives of the Municipality and in current year obligations being financed by the subsequent year budget.

Recommendation

The Mayor should regularly monitor the budget performance on a monthly basis and identify and address barriers to the planned levels of budget execution. Where the initial budget assumptions are found to be inaccurate, this should be addressed in the final budget.

The Mayor should ensure that the plan for own source revenues represents a realistic plan and corresponds to the opportunities of the Municipality to collect revenues. Furthermore, the Mayor should ensure that all necessary measures are taken to collect these revenues.

4.4 Revenues (including own source revenues)

Description

Own source revenues generated by the Municipality in 2013 amounted to EUR 40 thousand. There is a need for improvement in some processes and controls relating to the collection and reporting of revenues, in order to increase revenue collection and ensuring the accuracy and completeness of reporting for managerial purposes and for purposes of preparing the financial statements.

Issue - Controls on revenues - High Priority

Finding

- Until 2013, an automated billing system existed only for tax on property. The Municipality did not maintain billing records for other types of revenue. Instead, only cash collections from such revenue streams were recorded. Except for taxes on property, the Municipality did not maintain separate sub-ledgers or lists of all its debtors according to different types of taxes.
- In 2013, the Municipality sought to implement a billing system for other types of revenues. That system provides only basic information about taxes, whilst it lacks useful functions and automatic controls, such as the central authorisation of the approved tariffs and rates, review and authorization of data and records. In addition, the Municipality does not perform any formal reconciliation of revenues between all operational departments and the accounting department.

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- The annual verification of one third of the taxable properties which is required by Law no. 03/L-204, UA no. 03/2011 for real estate properties tax, was not made.

Risks

- There are uncertainties regarding the completeness of revenues that the Municipality may earn and the related receivables, and as a consequence the risk of errors in the financial statements is increased and the ability of the management to take decisions, control, identify and resolve these errors on time is impaired.
- Without detailed, accurate and sufficient data on the debtors, the Municipality is not able to prepare an accurate and reliable budget, to report an accurate collection ratio, and monitor the collection of revenues on time.
- Lack of verification for 1/3 of the existing properties, may result in the Municipality not having accurate and complete information on the actual properties, and consequently in lower taxes being assessed on property.

Recommendation

We recommend the Mayor ensures that the Municipality takes steps to improve the billing and accounting systems in order to ensure safe, efficient and effective controls on billing and revenue. Improvement of the procedures related to such systems would enable management to monitor and manage significant risks, and to ensure that decisions related to budgeting, planning and collection of revenues are properly carried out. We recommend that the Municipality considers to:

- Implement a billing system that includes updated details about the payers, their current address, history and collection rating. Such information should be accessible only to a limited number of people and with the authorization of management.
- Enter and centrally control the approved tariffs and tax rates in the system in order to calculate and generate bills automatically. The generation of bills should also be authorized and reviewed.
- Automatically inter-connect the billing system with the accounting software so that information is automatically processed into the general ledger.
- Automatically link the operational and billing units and perform regular reconciliations between them, in cases where the billing is directly related to services supplied by the operational units. This is especially important where a high volume of transactions is executed.
- Perform regular verifications and registration of taxable properties as required by applicable legislation.

4.5 Expenditures

Further improvements are needed in the controls and reporting of expenditures.

4.5.1 Procurement

Description

There are certain aspects of the procurement process, where the controls are not effectively implemented and the maintenance of complete required documentation is not ensured.

Issue - Incompliance with the applicable legislation - Medium Priority

Finding

The procurements No. 626-13-019-136 and 626-13-009-236 were processed as procurements for services, whilst they were financed by the capital investments' budget. If these expenditures were classified in the appropriate category, the budget for goods and services would have been exceeded by EUR 17 thousand.

Risk

Incorrect classifications of expenditure can lead to misstatements in the financial statements and in the reports for the purposes of performance and budget evaluation. Furthermore, incorrect classifications of expenditure can lead to the exceeding of budget, which is not in compliance with the law.

Recommendation

We recommend the Mayor ensures that the Municipality shall take further steps to improve controls over expenses and payments, and ensure that all required documentation is obtained and presented in strict compliance with laws and local regulatory requirements.

4.5.2 Non Procurement Expenditure

Description

No major exceptions identified.

Recommendation

We have no recommendations in this area

4.5.3 Remunerations (wages and salaries)

Description

We have identified lack of documentation in the employees files.

Issue - Delays in the reporting of payroll - Medium Priority

Finding

For two employees hired in 2013, we were not provided with the application form, candidate evaluation, interview documentation, qualifications, birth certificate and court certificate.

Risk

Lack of documentation in the personnel files is not in accordance with regulations and it can also lead to the selection of unsuitable employees.

Recommendation

We recommend the Mayor ensures that the Municipality maintains complete documentation regarding its employees.

4.5.4 Subsidies and Transfers

Description

The Municipality should adopt written and approved policies regarding subsidies.

Issue - Lack of written policies on subsidies - High priority

Findings

The Municipality does not have written policies on the subsidies that would contain criteria and the procedures for allowances, and as a result the subsidies are allowed only based on the decision of the Mayor.

Risk

Lack of policies and established criteria might result in inconsistent treatments of cases and lead to complaints from citizens and subjective assessments by the Municipality.

Recommendations

The Municipality should establish sufficient and adequate control procedures that would enable an effective monitoring over the compliance with the applicable laws and regulations regarding subsidies and transfers.

4.6 Assets and liabilities

4.6.1 Capital and non capital assets

Description

- Although the Municipality has taken steps to improve reporting on its properties, some uncertainties and weaknesses in relation to the assets of the Municipality still exist, and or recommendations on the Article 16 'Disclosures of Assets' have been partly addressed. Our findings detailed below, together have impacts that result in a significant risk, as described in Part 2 of this document.
- As a result of the lack of coordination and the frequent and regular reconciliation of information between the Municipality and third parties, the financial information presented by the Municipality may be incomplete and misstated.

Issue 1 - Uncertainties in relation to Article 16 'Disclosures of Assets' - High Priority

Finding

- For certain properties there are uncertainties regarding ownership rights of the Municipality or various other Kosovo Government Agencies and lack of supporting ownership documentation.
 - Due to lack of supporting documentation for the measurement of a significant part of these assets, the Municipality sought to measure them at fair value based on valuations of the main properties performed by an internally established committee. The balance of municipal buildings significantly changed during the years 2011, 2012 and 2013, whilst we were not provided with sufficient details on such changes.
 - The Municipality has not prepared a detailed list of the movements for the years 2013 and 2012 to ensure reconciliation of the information presented in the financial statements and has not kept a comprehensive register with information such as the date of acquisition and disposal of the assets, and the depreciation of the assets for the year. In addition, the Municipality does not maintain a separate register for assets with values of less than EUR 1,000. In the absence of reconciliations, the difference between the total amount presented in Article 16 'Disclosure of assets' for the year ended 31 December 2013 and the total at 31
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December 2012 is different by EUR 617 thousands from the additions of properties disclosed in Article 12.

Risk

- Although the Municipality has taken steps to address issues reported in the previous years in relation to the inaccurate and incomplete disclosures of properties and capital investments, such issues were the result of the absence of a process that would ensure completeness of information through regular communication and reconciliations between different sources, including third parties that are involved in financing the properties of the Municipality. Such process is not yet in place.
- Due to lack of ownership documentation there are uncertainties regarding ownership rights of the Municipality or various other Kosovo Government Agencies. As a result the Municipality may face difficulties in utilizing such properties in the future.
- The disclosure of assets is not complete, because not all property, plant and equipment were included in the valuation. Such deficiencies may result in significant values not included in the AFS, or in the wrong value of assets being presented, and in the inability of the management to control and exploit the resources in favour of the Municipality.

Recommendation

We recommend the Mayor to involve additional resources in the registration, control and valuation of the assets of the Municipality and to ensure that Municipality continuously records and presents all assets in its financial statements, and reconciles information from all sources involved in financing these assets.

Issue 2 - Payments from third parties - High Priority

Finding

- Free Balance is not used to record payments from third parties. Consequently, central information systems that are available for use by the Municipality do not provide comprehensive financial information on these payments.
- Payments from third parties of EUR 186 thousand that are presented in financial statements in 2013, comprise assets financed by the ministries with a total value of EUR 126 thousand, for which there is no evidence of transfer to the Municipality, and assets of EUR 32 thousand financed by USAID, that are not supported by any documentation. The corresponding assets are not presented in Article 16 'Disclosure of Properties' since the Municipality does not have any formal document from third parties to support the transfer of these assets to the Municipality.
- The Municipality was not provided with formal information from the Ministries during 2013, in relation to the capital investments that may have been financed by these Ministries in 2013 or earlier. As a result, the Municipality may have to perform significant adjustments to the amounts shown in its financial statements and in the assets register for properties financed by third parties, in the future periods.

Risk

Because of lack of coordination and reconciliation of data between third parties and the Municipality, the information presented by the Municipality might be incomplete and materially misstated.

Recommendation

We recommend the Mayor ensures that the Municipality is making its best efforts to obtain information on payments from third parties, with particular emphasis on those parties that are known to have made significant investments in the Municipality. The obtained information should be properly presented in the assets register of the Municipality. Best practice would require an annual reconciliation of information between third parties and the Municipality for the investments made during the year.

4.6.2 Handling of cash (and cash equivalents when applicable)

Description

Certain aspects of the liquidity management could be improved to ensure compliance with regulatory requirements and to avoid any potential cash misappropriation.

Issue - Delays on deposits of cash in bank - Medium priority

Findings

Cash received from citizens for health services was deposited at banks on a monthly basis. This practice is not according the Regulation no. 04/2007 of the Ministry of Health, which requires daily cash deposits. The reason for such deviation was the physical distance between the banks and the Municipality.

Risk

Lack of daily cash deposits at bank by the Municipality, may result in cash misappropriations and unidentified errors in reporting cash and cash equivalent balances.

Recommendation

We recommend that the Mayor ensures that cash is deposited and controlled on a daily basis.

4.6.3 Handling of receivables

Description

The Municipality does not have in place a robust process for planning, identifying, reporting and collecting invoices issued for its taxes.

Issue - Lack of controls over and assessment of the revenue collections - High Priority

Findings

The majority of receivables disclosed in the financial statements related to previous years. The Municipality has not taken necessary actions to collect these amounts and no aging analysis is performed.

Risk

Lack of sufficient controls over the collection of revenues and lack of the receivables aging analysis, have an adverse impact on the collection of revenues and as a consequence, on the funds generated by the Municipality to finance its expenses and investments. Such deficiencies impair the ability to identify issues, to monitor and allocate appropriate resources for the collection of revenues, and to report accurate and complete amounts of collectible amounts receivable in the financial statements.

Recommendation

We recommend that the Mayor ensures that the Municipality take further steps to improve controls and to comply with laws and local regulatory requirements regarding collections of revenues.

4.7 Handling of debts

Description

No major exceptions identified.

Recommendation

We have no recommendations in this area.

5 Internal Audit System

Description

We emphasize that it is important to address the absence of the audit functions, in order to enable the management to obtain assurance from the Internal Audit Unit in relation to the effective operations or the main controls over the important financial reporting systems.

Issue - Lack of an Internal Audit Department and Audit Committee - High Priority

Finding

The Municipality has not established an Internal Audit Department and an Audit Committee.

Risk

The absence of audit functions impairs the assurance obtained by the management in relation to the operation of financial systems and internal controls. This may result in unidentified weaknesses and continuity of inefficient practices that result in financial losses for the Municipality.

Recommendation

We recommend the Mayor ensures that the Municipality will establish an Internal Audit Department and an Audit Committee and compiles appropriate policies and procedures to ensure a high standard of corporate governance. The Audit Committee should review the current status and propose actions for improvement on the following:

- Municipality's accounting and financial reporting process;
- Assessment of internal control systems implemented by management;
- Internal and external audit processes;
- Review of compliance, reporting and control structures throughout the Municipality to ensure compliance with financial, regulatory and legal requirements.
- Compliance with financial, regulatory and legal requirements;
- Internal Audit plan and follow-up of Internal Audit findings.

Annex I: Explanation of the different types of opinion applied

(Taken 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 emphasized and indicate where the relevant disclosures that fully describe the matter can be found in the financial statements; and

To indicate that the auditor's opinion is not modified in respect of the matter emphasized.

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 judgment, 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 recommendation

Audit Component	Recommendation given	Recommendation fully addressed	Recommendation Partly addressed	Recommendation Not addressed
2.3 Compliance with AFS Reporting Requirements	We recommend the Mayor ensures that the Municipality prepares financial statements in the Serbian language.			To be addressed
2.3 Compliance with AFS Reporting Requirements	We recommend the Mayor ensures that the preparation of the Municipality's financial statements should include procedures and tools that are designed to ensure that information required is recorded, processed, summarized and appropriately reported in the financial statements.			
4.4 Revenues	We recommend the Mayor ensures that the Municipality takes steps to improve the billing and accounting systems in order to ensure safe, efficient and effective controls on billing and revenue.			To be addressed
4.5.1 Procurement	We recommend the Mayor ensures that the Municipality takes further steps to improve controls over expenses and payments and strictly comply with laws and local regulatory requirements.			To be addressed
4.5.4 Subsidies and Transfers	We recommend the Mayor ensures that The Municipality should establish sufficient adequate control procedures for effective monitoring over the compliance with the applicable laws and regulations regarding subsidies and transfers			To be addressed
4.6.2 Handling of Cash	We recommend that the Mayor ensures that the Municipality takes further steps to improve controls and to comply with laws and local regulatory requirements regarding cash collections			To be addressed

4.6.3 Handling of receivables	We recommend the Mayor ensures a process is designed and established, which ensures that receivables are recorded upon issuing of each invoice and that overdue amounts are followed up regularly.			To be addressed
4.6.1 Capital and non capital assets	We recommend the Mayor to involve additional resources in the registration and valuation of the assets of the Municipality.			To be addressed
5 Internal Audit System	We recommend that the Municipality should establish appropriate policies and procedures to ensure a high standard of corporate governance as well as an Internal Audit Department and an Audit Committee. The Audit Committee should review the current status and propose actions for improvement on the following.			To be addressed

Annex III: Management Response to Our Findings

Findings	Agree	Comments from the institution	KPMG view
<p>2.3 Compliance with AFS reporting requirements</p> <p>The primary reliable source of information for the preparation of financial statements is Free Balance, which is not being used to record and report all disclosures that are not prepared under the Cash Basis Accounting. Such disclosures include income from fines, payments from third parties, receivables and contingent liabilities.</p> <ul style="list-style-type: none"> Several roundings or small differences were identified in the notes to the financial statements and certain formats could be further improved to ensure a better presentation of financial statements. <p>The Municipality did not prepare reports in the Serbian language.</p>	Yes	We dont have an employee who would perform the ytranslation of AFS into Serbian language.	
<p>4.3 Budget Planning and Execution</p> <p>Actual own source revenues represent 67% of the budget for the year 2013, and decreased by 7% when compared to the revenues for the year 2012. Meanwhile, the budget execution was 93% of the final budget. Such execution represents a decrease of 1% when compared to the amounts reported in the year 2012.</p>	Yes		
<p>4.4 Revenues (including own source revenues)</p> <ul style="list-style-type: none"> Until 2013, an automated billing system existed only for tax on property. The Municipality did not 	Yes	The electronic collection in the Municipality (Electronic cashbox) has started since October 2013.	

<p>maintain billing records for other types of revenue. Instead, only cash collections from such revenue streams were recorded. Except for taxes on property, the Municipality did not maintain separate sub-ledgers or lists of all its debtors according to different types of taxes.</p> <ul style="list-style-type: none"> • In 2013, the Municipality sought to implement a billing system for other types of revenues. That system provides only basic information about taxes, whilst it lacks useful functions and automatic controls, such as the central authorization of the approved tariffs and rates, review and authorization of data and records. In addition, the Municipality does not perform any formal reconciliation of revenues between all operational departments and the accounting department. • The annual verification of one third of the taxable properties which is required by Law no. 03/L-204, UA no. 03/2011 for real estate properties tax, was not made. 			
<p>4.5.1 Procurement</p> <p>The procurements No. 626-13-019-136 and 626-13-009-236 were processed as procurements for services, whilst they were financed by the capital investments' budget. If these expenditures were classified in the appropriate category, the budget for goods and services would have been exceeded by EUR 17 thousand.</p>	Yes	The determination of limits for budget lines is done from Comission for Grants in the central level.	
<p>4.5.3 Renumerations (Wages and Salaries)</p> <p>For two employees hired in 2013, we were not</p>	Yes		

<p>provided with the application form, candidate evaluation, interview documentation, qualifications, birth certificate and court certificate.</p>			
<p>4.5.4 Subsidies and Transfers</p> <p>The Municipality does not have written policies on the subsidies that would contain criteria and the procedures for allowances, and as a result the subsidies are allowed only based on the decision of the Mayor.</p>	<p>Yes</p>	<p>Following a decision from municipal assembly, since April 2014 funds from this category are designated to all mothers after their childbirth in amount of EUR 100.</p>	
<p>4.6.1 Capital and non capital assets</p> <p>1. Article 16, 'Disclosure Assets'</p> <ul style="list-style-type: none"> • For certain properties there are uncertainties regarding ownership rights of the Municipality or various other Kosovo Government Agencies and lack of supporting ownership documentation. • Due to lack of supporting documentation for the measurement of a significant part of these assets, the Municipality sought to measure them at fair value based on valuations of the main properties performed by an internally established committee. The balance of municipal buildings significantly changed during the years 2011, 2012 and 2013, whilst we were not provided with sufficient details on such changes. • The Municipality has not prepared a detailed list of the movements for the years 2013 and 2012 to ensure reconciliation of the information presented in the financial statements and has not kept a comprehensive register with information such as the date of acquisition and disposal of the assets, and the depreciation of the assets for the year. In 	<p>Yes</p>		

<p>addition, the Municipality does not maintain a separate register for assets with values of less than EUR 1,000. In the absence of reconciliations, the difference between the total amount presented in Article 16 'Disclosure of assets' for capital and non capital assets, for the year ended 31 December 2013 and the total at 31 December 2012 is different by EUR 617 thousands from the additions of properties disclosed in Article 12.</p> <p>2. Payments from third parties</p> <ul style="list-style-type: none"> • Free Balance is not used to record payments from third parties. Consequently, central information systems that are available for use by the Municipality do not provide comprehensive financial information on these payments. • Payments from third parties of EUR 186 thousand that are presented in financial statements in 2013, comprise assets financed by the ministries with a total value of EUR 126 thousand, for which there is no evidence of transfer to the Municipality, and assets of EUR 32 thousand financed by USAID, that are not supported by any documentation. The corresponding assets are not presented in Article 16 'Disclosure of Assets' since the Municipality does not have any formal document from third parties to support the transfer of these assets to the Municipality. • The Municipality was not provided with formal information from the Ministries during 2013, in relation to the capital investments that may have been financed by these Ministries in 2013 or earlier. As a result, the Municipality may have to 			
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perform significant adjustments to the amounts shown in its financial statements and in the assets register for properties financed by third parties, in the future periods.			
4.6.2 Handling of cash (and cash equivalents when applicable) Cash received from citizens for health services was deposited at banks on a monthly basis. This practice is not according the Regulation no. 04/2007 of the Ministry of Health, which requires daily cash deposits. The reason for such deviation was the physical distance between the banks and the Municipality.	Yes		
4.6.3 Handling of receivables The majority of receivables disclosed in the financial statements related to previous years. The Municipality has not taken necessary actions to collect these amounts and no aging analysis is performed.	Yes	There are reports for each account receivable and its aging for type of taxes.	
5 Internal Audit System The Municipality has not established an Internal Audit Department and an Audit Committee.	Yes	Management of the Municipality will prepare action plans and establish proper policies for all activities.	