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**ZYRA KOMBËTARE E AUDITIMIT
NACIONALNA KANCELARIJA REVIZIJE**

NATIONAL AUDIT OFFICE

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AUDIT REPORT
ON THE ANNUAL FINANCIAL REPORT OF THE MUNICIPALITY
OF HANI I ELEZIT
FOR THE YEAR ENDED 31 DECEMBER 2016

Prishtina, june 2017

The National Audit Office of the Republic of Kosovo is the highest institution of economic and financial control which, according to the Constitution and domestic laws, enjoys functional, financial and operational independence. The National Audit Office undertakes regularity and performance audits and is accountable to the Assembly of Kosovo.

Our Mission is to contribute to sound financial management in the public administration. We perform audits in line with internationally recognized public sector auditing standards and good European practices.

The reports of the National Audit Office directly promote accountability of public institutions as they provide a base for holding managers' of individual budget organisations to account. We are thus building confidence in the spending of public funds and playing an active role in securing taxpayers' and other stakeholders' interests in enhancing public accountability.

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

The opinion and report issued are a result of the audit carried out by Florim Maliqi (Team Leader) Mexhit Ferati and Arben Hundozi (team members) under the management of the Head of Audit Department Fatlinda Ramosaj.

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Executive Summary

Introduction

This report summarises the key issues arising from our audit of the 2016 Annual Financial Report of the Municipality of Hani i Elezit, which determines the Opinion given by the Auditor General. The examination of the 2016 financial statements was undertaken in accordance with the International Standards on Supreme Audit Institutions. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The applied audit approach is set out in our External Audit Plan¹ dated 29.11.2016.

Our audit focus has been on:



For more details see Annex 1.

The level of work undertaken by the National Audit Office to complete the 2016 audit is a direct reflection of the quality of internal controls implemented by the Management of the Municipality of Hani i Elezit.

Opinion of the Auditor General

Unmodified Opinion with Emphasis of Matter

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

Emphasis of Matter

As Emphasis of Matter we would like to mention the fact that assets were understated by €207,011. In addition, the Municipality had misclassified expenditures in the amount of €40,624.

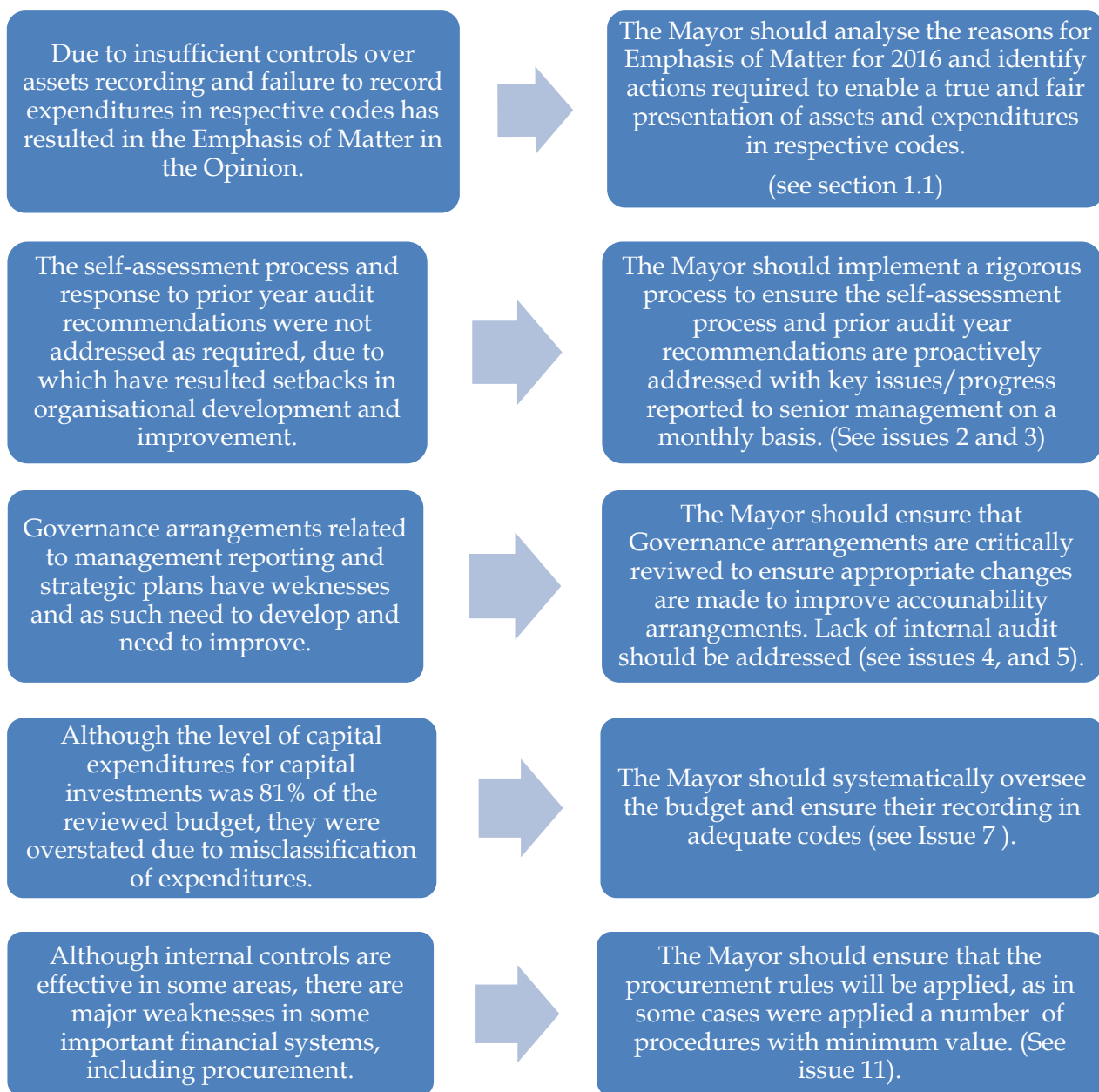
Full formulation of the opinion is given in detail in Chapter 1.1 of this report.

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

We would like to thank the Mayor and his staff for the cooperation during the audit process.

¹ The term External Audit Plan replaces the term Audit Planning Memorandum

Key Conclusions and Recommendations



Mayor's Response

The Mayor has considered the detailed audit findings and conclusions. The Mayor's comments on issues which we did not agree upon are detailed in Annex IV.

1 Annual Financial Statements and other External Reporting Obligations

Introduction

Our review of the Annual Financial Statements (AFS) considers both compliance with the reporting framework and the quality and accuracy of information recorded in the AFS. 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 declarations are intended to provide the Government with the assurance that all relevant information has been provided to ensure that a comprehensive audit can be undertaken.

1.1 Audit Opinion

Unmodified Opinion with Emphasis of Matter

We have audited the AFS of the Municipality of Hani i Elezit for the year ended on 31st of December 2016, which comprise of the Statement of Cash Receipts and Payments, Budget Execution Statement and the Explanatory Notes of the Financial Statements.

In our opinion Annual Financial Statements for the year ended on 31st of December 2016 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 Opinion

We conducted the audit in accordance with International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the AFS section of our report. We believe that the obtained audit evidence is sufficient and appropriate to provide a basis for the qualified opinion.

Emphasis of Matter

We draw your attention to the fact that:

The value of the assets recorded in the assets register and presented in the AFS was not complete as the Municipality had not managed to record all capital investments acquired during 2016 in the amount of €240,760, while on the other hand the value of overstated assets was €33,749 as a result of misclassification. The Municipality had misclassified expenditures as out of the category of Capital Investments had paid €33,749 for provision of home healthcare services that are managed by an NGO, while these expenditures are goods and services. Based on the report provided by the Municipality, the co-financing party for the abovementioned project has engaged eight health workers that provided services at the facility of Family Medicine Centre, and some field activities. In addition, the amount of €2,850 was paid for expenditures of rehabilitation of 15 persons in Spa of Klllokot. Beneficiaries of these expenditures were not municipal workers, but members of martyrs' families, while those expenditures belong to the category of Subsidies and Transfers, as well as expenditures in the amount of €4,025 for purchase of milking machines were recorded as subsidies which should have been recorded as capital transfers.

Responsibility of Management and Those Charged with Governance and AFS

The Mayor 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 and Chief Financial Officer are responsible to ensure 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 always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could influence the decisions taken on the basis of these AFS.

An audit involves performing procedures to obtain evidence about the financial records and disclosures in the AFS. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement in the AFS, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's

preparation of the financial statements in order to design audit procedures that are appropriate in the entity's circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

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

1.2 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;
- Compliance with Financial Rule no.02/2013;
- Action Plan on implementation of recommendations;
- Requirements of Financial Management and Control (FMC) procedure;
- Whether the AFS have been prepared within the timeframe and submitted to the MoF;
- Whether the draft and final procurement plan were submitted on time; and
- Whether the Municipality had prepared and submitted regular quarterly reports to the Municipal Assembly and one copy to the MoF.

Draft AFS contained some financial errors, and we have given a number of suggestions to the Municipality to improve their quality as follows:

- Designated donor grants in the budget execution report have been incorrectly presented in the amount of €44,000, in the column of final budget and execution, including grants carried forward from prior year in the amount of €10,000. They were also erroneously disclosed in Note 12;
- Utilities in the budget execution report, in the column of execution were presented correctly in the amount of €48,000 while in the disclosure of Note 4 were presented incorrectly in the amount of €49,000;
- Subsidies and transfers in the budget execution report in the column of implementation are correctly presented in the amount of €53,000, while in the disclosure of Note 4 were presented incorrectly in the amount of €54,000;

- Capital expenditures in the budget execution report, in the column of execution are correctly presented in the amount of €486,000, while in disclosure of Note 6 were presented incorrectly in the amount of €487,000;
- In Explanatory Notes 2 up to 6 in the column of final budget, is missing disclosure per economic codes, as is presented only the total;
- Article 24, report on unspent donor funds carried forward, has not been completed for current year or previous years.

The Municipality has considered our suggestions and the abovementioned errors have been corrected, while in the final AFS there are still errors that relate to:

- Disclosure of stocks was not accurate, as were not taken into account stocks of the Family Medicine Centre; and
- Summary of non-financial assets over €1,000 was not complete. This issue is dealt more extensively in subchapter 1.1 Audit Opinion.

DECLARATION BY THE MANAGEMENT OF THE MUNICIPALITY

Given the above - the Declaration made by the Chief Administrative Officer and Chief Financial Officer when the draft AFS are submitted to the Ministry of Finance can be considered to be accurate, with the exception of issue mentioned in the Opinion, which is not considered to have a material impact.

1.3 Recommendations for the first part of the report

On abovementioned issues is given the recommendation

Recommendation 1 The Mayor should ensure that an analysis is undertaken to determine the causes of Opinion with Emphasis of Matter, and to take adequate actions to eliminate errors in misclassification of expenditures and incorrect recording of assets. In addition, to ensure establishment of effective processes in order to confirm that the plan for drafting AFS for 2017 addresses all issues raised in the report, and the Declaration made by the Chief Administrative and Financial Officer should not be submitted unless all necessary checks have been applied to the draft AFS.

2 Governance

Introduction

Effective governance arrangements are fundamental to the management of the Municipality for successfully managing the challenges it faces and ensuring that service delivery is optimised for the benefit of taxpayers and other service users.

A key tool supporting effective Governance is the implementation of audit recommendations as this demonstrates that Management are seeking to develop existing processes and controls. Similarly, the self-assessment checklist completed by all Budget Organisations provides a framework for developing enhanced Governance arrangements. It is important that the answers provided by an individual budget organisation are supported by appropriate evidence.

The remainder of our review of governance arrangements reflects a consideration of:

- those areas of Governance Arrangements where significant improvements are required and where we believe that our recommendations can generate positive improvements including consideration of the Internal Audit system; and
- areas of Financial Management and Control identified through our audit work including specific work directed at compliance issues in key income and expenditure systems (these areas are considered in Section 3 of this report)

Overall Governance Conclusion

There are number of governance weaknesses within Municipality particularly related to accountability, risk management and the quality of management reporting.

The self-assessment checklist completed by the Municipality only partially reflects this situation, by responding to most of the questions with an average score of 2.46. According to the self-assessment list, the Municipality had given negative answers to 16 questions. This means that management should consider issues that have not reached the expected level.

One of the key elements of effective municipal governance is implementation of recommendations given by the external audit. This year's audit has revealed that the level of implementation of last year's recommendations was low, as only two out of nine recommendations were implemented.

The Municipality has a development plan, but this plan does not include cost calculation to measure results of its objectives. The municipal development plan contains more statistics than the development trend of the Municipality.

With the exception of risks list prepared in 2016 which lacks approach to these risks, the Municipality has not prepared the emergency plan and the anti-corruption plan.

2.1 Progress in the Implementation of Prior Year Recommendations

Our Audit Report on the 2015 AFS resulted in nine key recommendations. The Municipality of Hani i Elezit has prepared and submitted on time the Action Plan for implementation of prior year's recommendations. Our report was discussed in the Municipal Assembly. At the end of our 2016 audit, two recommendations have been implemented; three were in the process of being implemented, and four have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex III.

Issue 2 - Addressing Prior Year Audit Recommendations - High Priority

Finding Only a proportion of prior year recommendations have been implemented because the management has not implemented any formal process to manage and monitor the way that the AG's recommendations are implemented, nor has applied accountability measures related to non-addressing of recommendations.

Risk The continued weakness of management and other controls in key financial systems have resulted in:

- Repetition of misclassification of capital expenditures;
- Weaknesses associated with receivables from rent;
- Weakness in drafting of risks list; and
- Continued weaknesses in expenditures incurred through procurement and poor value for money;

Recommendation 2 The Mayor should ensure application of a strengthened accountability process by the responsible staff on implementation of recommendations in line with timeframes and priorities set out under the action plan. Monitoring of implementation progress should be done in a systematic manner, in order to eliminate barriers during the process.

2.2 Self-Assessment Checklist of FMC components

The Ministry of Finance has produced a detailed self-assessment checklist for Budget Organisations to support effective governance arrangements. We have tested the quality of FMC self-assessment submissions made to the Ministry by assessing one key question in each component of the checklist and summarised our findings below. This is not intended to give a commentary on the quality of the whole self-assessment questionnaire submission but will provide a 'snapshot' across a number of key questions to support the Ministry of Finance in its attempts to increase the effectiveness of the process and develop the FMC system as a whole.

Issue 3 - Self Assessment Checklist - High Priority

Finding	<p>As part of our audit we have considered key questions related to the five components of the self-assessment checklist. For the questions considered we found that:</p> <ul style="list-style-type: none">• The Self-Assessment questionnaire completed by municipal staff acknowledged that the Municipality has drafted the list of risks which can occur and affect achievement of objectives, but this list is missing adequate measures and actions of the management against potential occurrence of these risks;• Effective monitoring processes and Comprehensive strategy development (involving stakeholder liaison and ensuring a fully costed strategy) are not established by the Municipality.• The Municipality during 2016 had reported to the MoF on the physical and financial progress in line with the budget law, which have been reviewed in detail in sub-chapter 2.3.1;
Risk	<p>Poor governance arrangements weaken strategic and operational processes and reduce the quality of services provided to citizens through inefficient and ineffective activities.</p>
Recommendation 3	<p>The Mayor should ensure drafting of a comprehensive development strategy by including stakeholders and calculating costs for its implementation, and the list of risks is completed with measures that need to be taken in order to minimize the damage in case of risk occurrence.</p>

2.3 Specific Governance Reviews

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

2.3.1 Setting of Strategic Objectives

The Municipality is obligated to prepare and follow strategic plans at the organisation level, such as urban, spatial plans, emergency operational plan, strategic anti-corruption plan, regional development strategy, etc.

The Municipality has drafted a number of strategic documents, such as Urban Plan and the integrated development plan 2016-2018.

Issue 4 - Strategic Plans - High Priority

Finding	The Municipality did not have a strategic development plan from 2011, but had an overall development plan wherein has not clarified responsibilities for its coordination and development, and is missing calculation of costs of the development plan. The Municipality does not have an anti-corruption plan or emergency operational plan.
Risk	Due to lack of strategic plan is risked prioritisation of key issues that relate to orientation and long-term development of the Municipality, and make it impossible to follow-up fulfilment of objectives in terms of vision, as one of the essential conditions of good governance.
Recommendation 4	The Mayor should approve an overall strategic plan for the Municipality that would establish long-term objectives and serve as an orientation platform to draft annual plans, conduct comparative analysis between years and measure results against objectives.

2.3.2 Management Reporting and Accountability

A range of internal controls is applied by Management to ensure that financial systems and operational activities operate as intended. It is important that these include appropriate reporting to management to enable an effective and timely response to identified operational problems. After our reviews we have noticed the following weaknesses:

Issue 5 – Weaknesses in Management Controls – High Priority

- Finding** Our review of the management controls applied to Municipality’s key financial system highlighted poor quality financial reporting of expenditures, revenues, receivables, and payables to the senior management, and incomplete analysis of service delivery. This is because the format of management reports does not provide explanations for variances against budget and budget forecasts are not updated on a monthly basis. Similarly, operational targets are not systematically managed.
- Risk** Poor quality of financial and activity reporting to senior management reduces management’s ability to manage proactively the operations of Municipality and undermines effective budgetary control.
- Recommendation 5** 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 ensure that an appropriate solution is in place by the end of 2017.

2.4 Internal Audit System

The Municipality of Hani i Elezit does not have an Internal Audit Unit (IAU). The Internal Audit Department in Ministry of Finance, had provided internal audit services for 2015 and for the half of 2016 for the need of the Municipality.

Issue 6 - Lack of IAU - High Priority

- Finding** The Municipality of Hani i Elezit does not have an Internal Audit Unit (IAU). The Ministry of Finance, had provided internal audit services for 2015 and for the half of 2016 for the needs of the Municipality. Four recommendations were given for which the management has prepared an action plan for their implementation.
- Risk** The fact that audit services were partially provided by the MF for six month of 2016 can result in insufficient benefits to the management, namely in deficient assessments of internal controls.
- Recommendation 6** The Mayor should review budget possibilities to establish the IAU, which would contribute more to the assessment, and improvement of internal controls, alternatively, to continue obtaining annual services by the MF or another municipality that is nearby.

3 Financial Management and Control

Introduction

Our work on Financial Management and Control outside of the areas of Governance referred to in Chapter 2, reflects the detailed work undertaken on Revenue and Expenditure Systems of Budget Organisations. As part of this, we consider Budget management, Procurement and Human Resources issues, and Assets and Liabilities.

Financial Management and Control Conclusion

Procurement remains one of the main challenges for the Municipality, as regulations are not applied properly, and due to this has resulted poor value for money. The large number of annex contracts alone describes the weaknesses in procurement planning, and then failure to apply adequate procurement procedures considering the same nature of services. In the context of financial systems, controls over revenues in general are good, but controls over a range of spending areas require further improvement in order to prevent the Municipality from suffering budget damage. The main areas where more improvements are needed are payments on behalf of co-financing, misclassification of expenditures and collection of receivables, especially from business tax.

3.1 Budget Planning and Execution

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

Description	Initial Budget	Final Budget	2016 Receipts	2015 Receipts	2014 Receipts
Own Source Revenues	280,000	280,000	251,831	223,521	233,030

In 2016, the revenue plan was implemented at 90%, with a slight increase compared to 2015 (87%), while in 2014 it was 79%. Thus, in 2016, collections of own source revenues have not marked an increase compared to the prior year. Revenues including those carried forward from the prior year were mainly spent on capital projects in the amount of €256,641, for goods and services €14,932, for subsidies and transfers €23,158.

Table 2. Sources of budgetary Funds (in €)

Description	Initial Budget	Final Budget ²	2016 Outturn	2015 Outturn	2014 Outturn
Sources of Funds	2,066,396	2,309,939	2,189,897	2,094,367	1,902,070
Government Grant -Budget	1,786,396	1,856,678	1,851,081	1,901,743	1,620,495
Carried forward from previous year ³ -	-	129,093	106,108	44,134	27,144
Own Source Revenues ⁴	280,000	280,000	188,624	94,536	233,030
External Donations	=	44,168	44,084	53,954	21,401

The final budget compared to the initial budget was higher by €243,543. This change is a result of the increase of Government Grant by €70,282, revenues carried forward from prior year in the amount of €129,093, and External Donations by €44,168.

Budget execution in 2016 was €2,189,897, or 95% of the final budget, while in 2015 it was 93%, just as in 2014 93%. In general, the Municipality has shown a great budget performance, except for in the category of Capital Investments.

Table 3. Spending of funds by economic categories - (in €)

Description	Initial Budget	Final Budget	2016 Outturn	2015 Outturn	2014 Outturn
Spending of funds by economic categories	2,066,396	2,309,939	2,189,897	2,094,367	1,902,070
Wages and Salaries	1,366,516	1,396,798	1,391,497	1,366,432	1,239,194
Goods and Services	170,000	212,026	211,387	264,565	147,697
Utilities	44,533	48,814	48,264	48,061	35,918
Subsidies and Transfers	51,104	53,546	53,159	47,640	37,163
Capital Investments	434,243	598,755	485,590	367,669	442,098

Explanations about changes in budget categories are provided as follows:

- The capital investment budget in 2016 had increased by €164,512. The level of execution of the final budget was at 81%. Capital expenditures have marked an increase by €117,921 compared to 2015. The Public Investment Program includes eight on-going projects from the previous year and 16 new projects for the current year;
- The increase of budget for wages and salaries by €30,282 is as a result of payments for work experience;

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.

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- The increase of budget in the category of Goods and Services in the amount of €42,026 and Utility expenses in the amount of €4,281 was due to remained liabilities of the previous year;
 - The budget for subsidies and transfers has increased by €2,442 due to the need of assistance of non-public entities. Notwithstanding, at end of 2016 outstanding liabilities owed to individual beneficiaries were €6,000; and
 - External donations were €44,168, which were used for capital investments in the amount of €42,058, and €2,026 for goods and services.
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Issue 7 - Budget Execution - High Priority

Finding The Municipality has shown high efficiency in budget execution in almost all expenditure categories. However, a setback was noticed in the category of Capital Investment (81%) compared to other categories. This percentage decreases even more if we take into account the value of misclassifications. This has occurred due to lack of planning and systematic budgetary control by the Municipality and partially due to some external factors.

Risk Failure to execute the budget in line with initial projections will result in non-achievement of Municipality's objectives, and in financing projects and current year liabilities with next year's budget.

Recommendation 7 The Mayor should ensure and establish clear objectives for improvement of planning and budget execution in future periods, and establish a systematic monitoring over the planned budget execution, particularly for capital projects.

3.1.1 Revenues

The Municipality of Hani i Elezit collects several types of revenues but the most significant ones are from: property tax, vehicle registration tax, business tax, rented property and other administrative fees. The total of own source revenues in the Municipality collected during 2016 was €251,831, or 90% planned.

Despite controls established by the Municipality, we have identified some important issues from audit of revenues:

Issue 8 - Failure to implement the software on business tax- High Priority

Finding The Municipality has an accounting software for recording and reporting business tax revenues. This software purchased in 2012 in the amount of €9,800 had remained only as a passive asset of the Municipality, as it was never applied in practice. According to officials of the Municipality, the software was intended to be used for recording business tax, but unfortunately it was not used by the Directorate for Economic Development. Records on 257 businesses are kept in an Excel spreadsheet, but this software program does not provide much analytical information on each business.

In addition, while testing eight samples we noticed that the Municipality had issued decisions for operation of businesses with high debts, where the debt ranged from €2,430 to €74,000 per EO. In decisions issued for operation by the Municipality it is stated that liabilities owed to the Municipality should be paid by 15.06.2016. This criterion was not fulfilled by businesses while Municipality had not given any written warnings or applied any measures.

Risk Failure to apply the Software in practice for unknown reasons speaks of a poor performance over the management of business tax database. Manual implementation of system for collection of information on tax revenue can be subject to manipulation with data or errors. In addition, making decisions to allow business exercise their activity without paying prior year liabilities risks collection of revenues under the plan and use them based on priorities.

Recommendation 8 The Mayor should uncover the reasons why purchased software has remained passive for many years, and ensure that it will be operational so that the database provides sufficient information on each business or seek an improvement to the existing format of record- keeping in Excel. In addition, should demand concrete actions from competent bodies to stop those businesses that have not met liabilities towards the Municipality.

Issue 9 - Forgiving debts without a legal basis - High priority

Finding The Director of Urbanism had taken an independent action related to debts of renters. We have found that to 14 renters of municipal property were forgiven debts in the amount of €6,615, based on the law on debt forgiveness. This law does not foresee forgiveness of rent debts.

Risk Forgiving rent debts without a legal basis is in contradiction with law and causes financial losses to Municipality. Furthermore, forgiving the debt to renters that have not paid rent for years can cause dissatisfaction among other renters who have been paying rent constantly.

Recommendation 9 The Mayor should review abovementioned cases of debt forgiveness and ensure that debts are forgiven only for the categories permitted under applicable laws and regulations. Prior to making decisions, cases should be reviewed in advance and ensure that decisions taken are in full compliance with relevant laws or regulations.

3.1.2 Wages and Salaries

Wages and Salaries are paid through a centralised system. Key controls that operate at a local by the Municipality relate to: checking payments, signing payroll list, verification of potential changes that can be presented through forms, budget review for this category as well as reconciliation with Treasury. Expenditures for wages and salaries for 2016 were €1,391,497 or about 100% of this this category's budget.

Issue 10 - Incorrect categorisation of grading - High Priority

Finding In one case we have identified that an employee in the department of primary health services was categorized in the grade of a specialist doctor, while he does not have evidence of this qualification. Due to incorrect grading, the base annual salary was higher by €1,092.

Risk Due to the failure to categorise properly employees in line with grades specified for classification of salaries has resulted in overpayments of salaries, namely in irregular spending of the budget.

Recommendation 10 The Mayor should strengthen controls over the processing of personnel data in the payroll system, and ensure that are taken necessary actions for correct categorisation of employees in line with adequate classification of salary grades.

3.1.3 Goods and Services and Utilities

The final budget for goods and services in 2016 was €212,026, which were spent almost entirely (€211,387). Outstanding liabilities for goods and services at the end of 2016 were €3,380.

Recommendation

We have no recommendations in this area.

3.1.4 Subsidies and transfers

The final budget for subsidies and transfers was €53,546. Out of them were spent €53,159. The amount of €12,025 was spent on subsidies to public and non-public entities, while the amount of €41,134 was spent as transfers of funds to individual beneficiaries.

Weaknesses identified in this areas have been handled in the basis for opinion.

3.1.5 Capital Investments

The final budget for capital investments was €598,755. Out of them were spent €485,590. The Municipality of Hani i Elezit in 2016 has developed 88 procurement activities.

Issue 11 - Entry into contracts with minimal value - High priority

Finding

According to the procurement list, we have found that were developed 51 procurement activities by applying minimal value purchase procedure. Within these activities, there were cases where more than one procedure was developed for same procurement items, and there were cases of contracts that were not foreseen in the procurement plan.

- According to the procurement plan, drafting of projects was foreseen to be €15,000, while were developed six procedures with minimal value for this type of purchase;
- Maintenance of public lighting was not included in the procurement plan, although this service takes place every year, while were developed two procedures with price quotation for this type of purchase;
- For maintenance and servicing of vehicles were planned €9,000, while were developed three separate procurement procedures as a result of non-inclusion of all vehicles that the Municipality owns; and

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- The supply of official material was planned to be €4,500, while were developed four separate procedures. In one case was developed an open procedure, and in three cases the contracts were of minimal value and were entered into with the same Operator.

Risk Due to splitting of requests and frequent development of procedures with minimal value or with price quotation for the same items results in lack of transparency and in elimination of competition due to non-use of open procurement procedures.

Recommendation 11 The Mayor should ensure that procurement office gathers all requests for the same purchase in order to enable development of open procurement procedures. This would enable greater competition and more favourable prices for the municipal budget.

3.2 Assets

3.2.1 Capital and Non Capital Assets

During 2016 the Municipality has not managed to record assets over €1,000, as from September 2016 assets officer had terminated the contracts with the Municipality. Failure to record capital assets in their adequate categories was addressed in the section Opinion with Emphasis of Matter, while the following we will present some other issues that Municipality should have taken into account 2017.

Issue 12 – Inventory and use of e-assets - High Priority

Finding Under a decision, the Mayor had appointed an inventory committee on 07.08.2015. This committee had not completed its work even at the end of our audit on 12.05.2017, namely there is a delay of almost two years.

Risk Due to the failure to inventory assets poses a risk of not identifying all assets owned by the Municipality, which could result in their mismanagement, damage or even loss.

Recommendation 12 The Mayor should ensure that the inventory committee hurries to complete the work already started and submit the final report with the. Alternatively, establish a new inventory committee.

3.2.2 Handling of Cash and Cash Equivalents

Issue 13 –Bank deposits – High Priority

Finding According to the financial rules, the Municipality can collect all funds up to €10 in cash and at the end of the day are deposited in the bank. We have noticed delays in depositing €649, which were collected from 18.01. 2016 up to 22.01.2016, and from 19.09.2016 up to 23.09.2016, while they were deposited in the bank on 25.01.2016, respectively 26.09.2016. This is a common practice in the Municipality of Hani i Elezit.

Risk Failure to implement Treasury rules on depositing public funds at the end of the day, poses a risk of loss or misuse of funds.

Recommendation 13 The Mayor should ensure that this practice is stopped and implemented requirement of financial regulations, so that all cash collected, is deposited into the bank within legal deadlines.

3.2.3 Receivables

Municipality's Accounts Receivable represent amounts that citizens and organisations owe to the Municipality for services, works, goods or properties that they have been benefited from the Municipality. According to the data presented in the AFS, the total amount of these Accounts at the end of 2016 was €451,291.

Issue 14 – High level of uncollected debts – High priority

Finding Even though the property tax revenues make up the largest part of own source revenues, at the end of 2016 they resulted in uncollected debt of €195,641. Another important case was also with business tax debts where at the end of 2016 the uncollected amount was €241,124, while from renting municipal property were €14,526. These three types were presented as accounts receivable at the end of the year. We have not noticed that the Municipality has any concrete strategy to collect/reduce receivables.

The municipality for 2016 has charged businesses tax in the amount of €89,585, while were collected €70,458 or 79% of the plan. According to the financial report at the end of 2016, the amount of receivables remained at €241,124. Moreover, the municipality had not taken any concrete actions such as a remark in written or any other measures.

Risk Due to continuous increase of accounts receivable reduces Municipality's ability to finance projects from own source revenues. Delay in drafting a strategy for collection of arrears can lead to a situation that after a certain period they become bad debts and not collectible.

Recommendation 14 The Mayor should ensure a comprehensive approach in treating receivables. The management should initiate a reassessment process where all accounts will be analysed in terms of age, significant amounts, and real opportunities for collection, and exercise administrative measures for their collection.

3.3 Outstanding Liabilities

The statement of outstanding liabilities owed to suppliers at the end of 2016 was €10,231, while in 2015 were €29,688. In addition, at the end of the year were presented contingent liabilities as legal contests in the amount of €70,600, while in the prior year they were €72,000. While analysing accounts payable we noticed that the Municipality in 2016 had paid €32,184 as outstanding liabilities of 2015.

Issue 15 – Poor management of liabilities - High priority

Finding Based on an analysis we found that the Municipality in 2016 had paid invoices of 2015 in the amount of €32,184, while outstanding invoices presented at the end of 2015 were €29,688. According to this analysis it turns out that the Municipality had not properly presented its liabilities whereby has caused their understatement by €2,496;

The Municipality did not have a proper cash flow plan for payment of incurred liabilities. At the end of 2016 were recorded liabilities from the category subsidies and transfers in the amount of €6,300, while the remaining budget for this category was €387. Thus, the budget for this category was exceeded by €5,913.

Risk The Municipality has not presented prior year's liabilities correctly and accurately and as a result has underestimated its liabilities. In addition, entering into liabilities beyond budget appropriations, especially for subsidies and transfers, poses a risk as a part of current year's budget may be spent on prior year's liabilities.

Recommendation 15 The Mayor should ensure that there is a fair and timely reporting of all outstanding invoices from all departments, and to ensure that budget planning is based on a clear cash flow plan, so that budget appropriations are not exceeded by any means.

This report is a translation from the Albanian original version. In case of discrepancies, Albanian version shall prevail.

ANNEX I: Audit Approach and Methodology

The responsibilities placed on the Auditor and Those Charged with Governance are detailed in the Opinion set out in Section 1.2 of this report.

While a key output of our work is the audit opinion this report reflects the totality of our work with specific focus also on Governance Issues including Financial Management and Control. The latter is informed by our extensive, risk based, compliance audit programme.

The Executive Summary is intended to highlight the key finding of the audit and the key action that the Mayor should ensure are taken to address identified management/control weaknesses.

The detailed report provides an extensive summary of our audit finding with emphasis on determining the cause audit findings and providing appropriate recommendations to address these. For completeness we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

High Priority - issues which if not addressed may result in a material weakness in internal control and where action will offer the potential for improvements to the efficiency and effectiveness of internal controls; and

Medium Priority - issues which may not result in a material weakness but where action will also offer the potential for significant improvements to the efficiency and effectiveness of internal controls.

Findings considered low priority will be reported separately to finance staff.

Our procedures included a review of the internal controls and accounting systems and associated substantive testing and associated governance arrangements only to the extent considered necessary for the effective performance of the audit. Audit findings should not be regarded as representing a comprehensive statement of all the weaknesses which exist, or all improvements which could be made to the systems and procedures operated.

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

(extract from ISSAI 200)

Form of opinion

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

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

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

Modifications to the opinion in the auditor's report

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

Determining the type of modification to the auditor's opinion

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

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

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

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

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

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 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 III: Prior Year Recommendations

Audit Component	Recommendation given	Implemented	Under implementation	Not implemented
1.4 Compliance with AFS and other reporting requirements	High Priority – The Mayor should ensure that an analysis is undertaken to determine the causes that led to Emphasis of Matter. It is necessary to undertake to be undertaken appropriate actions to address the causes behind non-recording of assets in the KFMIS and correct presentation of assets in the AFS.			Not implemented. Lack of assets officer.
2.3 Prior Year Recommendations	The Mayor should strengthen control measures and responsibilities to the persons appointed to address fully recommendations so that actions foreseen under the Action Plan are implemented, particularly in the areas of high risk and with the timeframes specified.	Yes, this recommendation was implemented.		
2.4 FMC Self-Assessment Checklist	The Mayor should ensure that a review of the processes for completing the self-assessment checklist and proactively addressing areas of weaknesses is implemented.	Yes, this recommendation was implemented.		

2.5.1 Risk assessment	The Mayor should ensure that, after having drafted the list of risks with respective levels, immediate responsibility for risk management is delegated to a named director who, in cooperation with the heads of units, will manage and regularly report on the progress of the process.		Partially, because it was not foreseen the approach of risk management.	
2.6 Internal Audit System	The Mayor has to consider the possibility of obtaining internal audit services, in order to test appropriateness, effectiveness and functioning of organization's internal controls.		Partially, because the management did not require audit services which would cover the year period.	
3.3 Budget Planning and Execution	The Mayor should ensure that budget performance is systematically monitored and that barriers to planned levels of budget execution are identified and addressed.			Not implemented. Due to not proper planning of expenses and not taking into consideration of external factors such as weather climate the implementation of the recommendation has not been addressed.

3.4 Procurement	The Mayor should initiate a thorough analysis in order to determine why weak procurement practices were applied in these cases and enhance controls, which ensure that: procurements reflect needs; tender specifications reflect current requests of departments. In general, the procurement controls need to be strengthened.		Partially, because in some cases there have been procurements with minimum value.	
3.4.1 Remunerations (Wages and Salaries)	The Mayor has to review the internal regulation applied so far by the municipality, and correct the same in accordance with organic regulations and apply it adequately in order not to "hurt" the municipal budget.			Not implemented. No concrete action was taken.
3.5.3 Handling of debts	The Mayor should ensure full reporting of liabilities and strengthen controls and discipline of officials responsible for forwarding of outstanding invoices to the finance department. For handling of contingent liabilities in coordination with the municipal legal representative should undertake a review of the condition of liabilities, in order to determine the priority of payments, by avoiding direct payments from the MoF.			Not implemented. Lack of reporting on time for unpaid bills.
Total	9	2	3	4

Annex IV: Comments of the Municipality on audit findings

Findings/issues	Agree Yes/No	Municipality's comments in case of disagreement	OAG view
Emphasis of matter	No	<p>You highlighted that the Municipality has misclassified expenditures of €40,624.</p> <p>Our opinion is that the Municipality has misclassified expenditures of just €33,749, not as much as the amount highlighted above.</p> <p>The amount of €2,850 was paid on behalf of the expenditures for the rehabilitation of 15 persons in Kllokot's SPA and you have highlighted that these expenditures belong to the category of Subsidies and Transfers</p> <p>We have entered into a contract with the EO which provides a service to us and our opinion is that it is not part of the misclassification.</p> <p>You have highlighted that expenditures in the amount of €4,025 for purchase of milking machines were recorded as subsidies which should have been recorded as capital transfers.</p> <p>Our opinion is that expenditures in the amount of €4,025 for purchase of milking machines have incurred from the adequate code and individual persons have benefited from this, so they cannot be recorded as assets.</p>	<p>Your comments have been considered and nothing in the findings presented in the report will change.</p> <p>Your comments are more justifications rather than providing valid evidence to change the report.</p>
Issue 8: Failure to implement the software on business tax	No	<p>There is a malfunction in the program of the business tax software. We have asked the company to fix the program.</p>	<p>By the time of the audit, the software was not functioning.</p>
Issue 9: Forgiving debts without a legal basis	No	<p>We have referred to the Law no.05/L-043 on Debt Forgiveness, Article 4, stating that all persons who have outstanding debts to state institutions and POEs shall benefit.</p>	<p>The Municipality has forgiven rental debts which are not allowed by the law.</p>

<p>Issue 12: - Entry into minimal value contracts</p>	<p>No</p>	<p>2. <i>Maintenance of public lighting was not included in the procurement plan, although this service takes place every year, while were developed two procedures with price quotation for this type of purchase;</i></p> <p>2. In regard to Public Lighting, you have been provided with the agreements signed with co-financing from Capital Investments, section 4. Free co-investment funds (where we have mutual understanding agreements with two villages for co-financing the project in question). You have received the evidence, and you have copied it and taken it with you). Public lighting is also in the budget list.</p> <p>In the meeting that we had with you, we have submitted the evidence to you.</p> <p>3. <i>For maintenance and servicing of vehicles were planned €9,000, while were developed three separate procurement procedures as a result of non-inclusion of all vehicles that the Municipality owns;</i></p> <p>3. The Municipality of Hani i Elezit have developed medium procedure for maintenance and servicing of all vehicles of Hani i Elezit and we did not have any bidders (date of announcement for the middle value 28.10.2016 and the bids opening's 16.11.2016). We have cancelled the procurement procedure (on 21.11.2016) and because there were many vehicles in need for servicing, we have been obliged to split the tender in two procedures: 1. <i>Maintenance of vehicles for the municipal ad. announced in the PPRC on the 16.12.2016 and opened on 26.12.2016 (So open or public procedure); The announcement is made public in the PPRC and there was no suspicions on favouring, if this is what you are alluding. For your information, since February 2016, all procedures over €1,000 are made public and announced in the PPRC and are open to all interested operators.</i></p> <p>4. <i>Supply with stationery was was planned to be €4,500, while were developed four separate procedures. In one case was developed an open procedure, and in three cases the contracts were of minimal value and were entered into with the same Operator?</i></p>	<p>There is no relevant evidence to change the findings in the report.</p> <p>The report remains unchanged.</p>
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Issue 13: Inventory and use of e-assets	No	Inventory started in time, but it was not completely finished (the standstill is in the education sector, some schools)	Inventory was not done, nothing more is said in the report.
Issue 15: High level of uncollected debts	No	The municipality has developed court proceedings for non-payment to economic operators, but the parties complained to the second instance. Please find attached some of the evidence we have.	The fact that the Municipality has filed a lawsuit does not change the situation.