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**ZYRA KOMBËTARE E AUDITIMIT  
NACIONALNA KANCELARIJA REVIZIJE**

**NATIONAL AUDIT OFFICE**

**Document No: 22.4.1-2016-08**

**AUDIT REPORT**  
**ON THE ANNUAL FINANCIAL REPORT OF THE MUNICIPALITY  
OF ISTOG 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 Istog* 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 Edon Kabashi (team leader) and Pleurat Isufi and Mehmet Kurti (team members) under the management of the Head of Audit Department, Astrit Bllaca.

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# Executive Summary

## Introduction

This report summarises the key issues arising from our audit of the 2016 Annual Financial Report of Istog Municipality, 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 Plan<sup>1</sup> dated 08.11.2016.

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.

## Opinion of the Auditor General

### Unmodified Opinion with Emphasis of Matter

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

### Emphasis of Matter

As an emphasis of matter, we would like to draw your attention to the fact that assets over €1,000 were understated for €2,259,930 because they were not included in the PFV. Moreover, 1,540 land plots were registered neither in the asset register nor in the accounting register, whilst capital purchases under €1,000 in the Health and Education sector were not registered in the e-assets system. Accounts receivable were also understated for €274,000

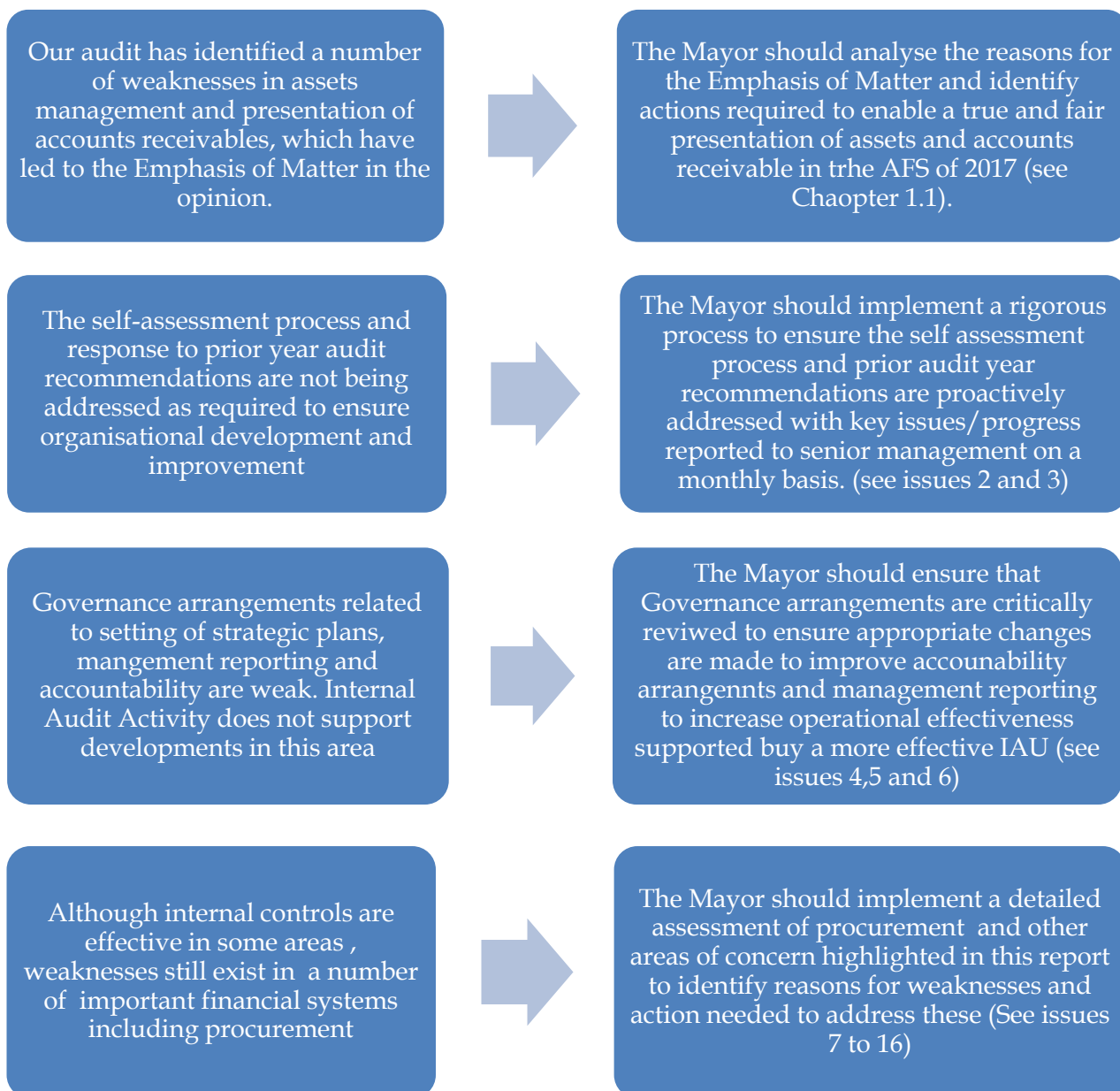
For more, please see Section 1.1 of this Report

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

<sup>1</sup> The term External Audit Plan replaces the term Audit Planning Memorandum

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

### Key Conclusions and Recommendations



### Mayor's Response

The Mayor has considered and agreed on the detailed audit findings and conclusions and has committed to address all given recommendations. In addition, the Mayor is committed to:

- discuss the audit report in the Municipal Assembly; and
- By the end of January 2018, he shall discuss in the Municipal Assembly about the progress in the implementation of audit recommendations Action Plan before the annual financial statements of 2017 are submitted to the Ministry of Finance.

# 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 Executive Officer 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 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 Istog for the year ended on 31<sup>st</sup> 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, the Annual Financial Statements for the year ended on 31<sup>st</sup> 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 the 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 opinion.

**Emphasis of Matter**

We draw your attention to the fact that:

- The net value of assets registered in KFMIS in 2016 was €14,753,930, whilst the value disclosed in the AFS was €12,494,000, i.e. assets were understated for €2,259,930;
- Municipal assets were understated as a result of failure to register 1,540 municipal land plots in KFMIS accounting register;
- The e-assets register was not accurate because capital purchases under €1,000 in Health and Education were not included in this register; and
- Accounts receivable were understated for €274,000. The closing balance of accounts receivable on property tax presented in the AFS was €595,000, whilst the value of accounts receivable according to Protax was €869,000.

**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 is responsible to ensure oversight the 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.

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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

The 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 with Law no.03/L-221, Law no. 04/L-116 and Law no. 04/L-194;
- 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) procedures;
- Submission of regular quarterly reports to the Municipal Assembly; and
- Draft and final procurement plans in time.

Issues raised in the Audit Memorandum dated 12.12.2016 regarding the reporting framework were partially addressed by the Management.

The draft AFS contained a number of errors for which we made suggestions to improve. The Management has considered our suggestions and corrected the final AFS, except for the findings presented under sub-chapter 1.1 Audit Opinion.

### DECLARATION BY THE MANAGEMENT OF THE MUNICIPALITY

Given the above - the Declaration made by the Chief Executive Officer and Chief Financial Officer when the draft AFS are submitted to the Ministry of Finance can be considered to be correct, except for the issues highlighted in sub-chapter 1.1 Audit Opinion which do not have material impact.



## 1.3 Recommendations for the first part of the report

For the abovementioned issues, we recommend:

**Recommendation 1** The Mayor should ensure that an analysis is undertaken to determine the causes of the emphasis of matter. Proper actions should be taken to have all assets registered in the respective assets registers and to remove current errors in the accounting registers in order to ensure that assets are correctly recorded and accounts receivable fully disclosed.

## 2 Governance

### Introduction

Effective governance arrangements are fundamental to 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 is a number of governance weaknesses within the Municipality particularly related to accountability, risk management and the quality of management reporting. The self-assessment checklist completed by the Municipality only partially recognises this situation with some positive comments about existing arrangements not evidence based.

A key tool for supporting effective governance is the implementation of audit recommendations is. The level of implementation of prior year recommendations was not satisfactory because only three (3) out of 16 recommendations were fully implemented.

The Municipality has a local economic development strategy for 2017-2021 in place and was in the process of finalising and sending it to the Municipal Assembly for approval. But, there was no such document when it comes to 2016.

Internal Audit did not provide a clear overview on internal controls' level of assurance because three (3) audits were conducted, one of which covered year 2015.

In 2016, the Municipality used 96% of the final budget, around 1% less than the previous year.

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## 2.1 Progress in the Implementation of Prior Year Recommendations

Our Audit Report on the 2015 AFS resulted in 16 recommendations. The Municipality prepared an Action Plan stating how all recommendations will be addressed. By the end of our audit for 2016, three (3) recommendations were implemented, six (6) were in the process of implementation and seven (7) were not implemented yet.

The Audit Report on AFS of 2015 was discussed in the Municipal Assembly.

For a more thorough description of the recommendations and how they are addressed, see Annex III.

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### Issue 2 – Implementation of Prior Year Audit Recommendations – High Priority

**Finding** Only a proportion of prior year recommendations have been implemented because the Municipality has not implemented any ongoing process to manage the way that the AG's recommendations are implemented. Seven (7) of the unimplemented recommendations relate to good governance, non-procurement expenditures, wage remunerations, revenues and assets.

**Risk** As long as recommendations given are not addressed, continued weakness of management and other controls in key financial systems will continue to be present and operational risks will not be corrected.

**Recommendation 2** The Mayor should ensure that a strengthened process of accountability towards the staff in charge with the implementation of recommendations, with deadlines and priorities set in the action plan is implemented. Implementation progress should be monitored systematically and where setbacks are identified adequate measures should be taken.

## 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. For all audits we undertook 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. We have summarised our findings for the Municipality 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.

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**Issue 3 – Self Assessment Checklist – High Priority****Finding**

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:

1. The Self-Assessment questionnaire completed by the Municipality acknowledged that required risk management systems were not yet in place. This situation has arisen because the Municipality did not develop the list of risks for 2016;
2. The Municipality is in the process of producing a five-year governance and economic development strategy (2017-2021) which was not finalised during 2016. Issues related to strategic plans are considered further in section 2.3.1;
3. Links between the procurement plan and budget and the production of adequate reports on a timely basis are not considered in place by the Municipality; and
4. Internal Audit did not highlight the above issues. Furthermore, the action taken to address issues identified in the 2016 self-assessment checklist is limited. This situation has occurred because of a lack of clarity within the Municipality regarding both the importance of this checklist and who is the responsible officer for using it to support operational improvements.

**Risk**

Poor governance arrangements weaken strategic and operational processes and reduce the quality of services provided to citizens through inefficient and ineffective activities.

**Recommendation 3**

The Mayor should ensure that a review of the processes for completing the self-assessment checklist and proactively addressing areas of weaknesses is implemented. Internal Audit should be involved in the final review process to confirm the accuracy of the return and to ensure supporting documentation.

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## 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 the Municipality operates and the challenges that it faces.

### 2.3.1 Setting of Strategic Objectives

All Budget Organisations are obliged to prepare and submit organisation level strategic plans.

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#### Issue 4 – Lack of Strategic Development Plans and Other Plans – High Priority

**Finding** There was a Regional Development Strategy produced in the Municipality, but it related to an earlier period, 2010-2013.

In 2017, the Municipality drafted the "Contingent Plan on strong winds and floods in the Municipality of Istog", "Risk Assessment for the territory of Municipality of Istog" and the "2017-2021 Local Economic Development Strategy for the Municipality of Istog". The municipality did not possess such documents when it comes to 2016.

**Risk** Strategic orientations, which are based on the Municipality's operational activities, are of a specific importance and the lack of these makes the follow up on municipal objectives' achievement, as one of the essential requisites of good governance, impossible.

**Recommendation 4** The Mayor should timely draft strategic plans on the development of the Municipality, with clear strategic objectives set and propose them to the Municipal Assembly for approval. He should also ensure the oversight and measurement of the achievement of such objectives on regular basis.

### 2.3.2 Management Reporting and Accountability

A range of internal controls are 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.

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#### Issue 5 – Weaknesses in High Level Management Controls – High Priority

**Finding** Our review of the management controls applied to the Municipality's key financial system highlighted poor quality financial reporting of expenditure and revenue to senior management and an incomplete analysis of service delivery. The internal reporting process has resulted in a number of weaknesses which restrains a more effective management. Responsibilities are limited and not being properly discharged.

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**Risk** Poor accountability and financial reporting processes has reduced the Municipality's effectiveness in financial management given that the lack of valuable and relevant information makes the decision-making difficult.

**Recommendation 5** The Mayor should ensure that a review is implemented to determine the format of financial and operational reporting to senior management which is required to support effective business management.

## 2.4 Internal Audit System

The Internal Audit Unit (IAU) operates with one member of staff. For 2016, IAU planned four (4) audits whilst managed to finalise three (3) of them. The finalised reports related to: (1) Procurement Unit, (2) Urban Department, (3) Administration Department whilst the planned report on Own Source Revenues and Expenditures in Health was not finalised. The Audit Committee held three meetings and discussed the internal audit reports.

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### Issue 6 – IAU Failure to Fulfil the Audit Plan – High Priority

**Finding** The Municipality did not fulfil the audit plan for 2016. From four (4) planned audits, three (3) were finalised one of which covered year 2015.

**Risk** Focusing the audits on previous years and failure to fulfil the audit plan increases the risk of poor and ineffective operation of internal controls established by the management and may lead to failure to identify system shortcomings and constant repetition of errors.

**Recommendation 6** The Mayor and the Director of IAU should work together to provide for sufficient reviews on current year financial systems. In the coming years, fulfilment of activities planned by IAU should be monitored on an ongoing basis and actions should be taken in order to timely address departures from the plan.

## 3 Financial Management and Control

### Introduction

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

### Financial Management and Control Conclusion

In the context of financial systems, controls are put in place but are not being effectively applied for specific categories. The procurement process needs to have a more effective monitoring of contract management; handling of payments in terms of accounting should be consistent with the reporting framework; controls over revenues in general have not been sufficient and are not being effectively applied, confirmation of summary notes – balance sheets in the preparation of the PFV; and an improvement in the management of assets and accounts receivable.

#### 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:

**Table 1. Own source revenues (in €)**

Description	Initial Budget	Final Budget	2016 Receipts	2015 Receipts	2014 Receipts
Own Source Revenues	1,020,000	1,020,000	1,061,435	941,133	936,047

Revenues collected in 2016 were exceeded by 4% compared to the final budget. Receipts included revenues from traffic fines, court penalties and revenues from the sale of wood amounting to €154,137<sup>2</sup>, which were collected by central institutions.

Own source revenues of €1,020,000 were allowed to be spent for the Municipality's needs during 2016. Out of that amount, €721,525 were spent whilst the remaining of €298,425 were carried forward in 2017. The total of unspent revenues out of the collected ones was €369,911. The collected revenues for 2016 reflects an increase of €120,302 or 13% more compared to the previous year.

<sup>2</sup> Traffic fines from Kosovo Police €43,311; court penalties €93,486 and Kosovo Forestry Agency €17,340

**Table 2. Sources of budgetary Funds (in €)**

Description	Initial Budget	Final Budget <sup>3</sup>	2015 Outturn	2014 Outturn	2013 Outturn
<b>Sources of Funds</b>	<b>8,796,498</b>	<b>9,238,311</b>	<b>8,846,553</b>	<b>8,878,415</b>	<b>8,176,752</b>
Government Grant -Budget	7,776,498	7,872,930	7,865,277	7,711,699	7,420,977
Carried forward from previous year <sup>4</sup> -	-	218,134	145,246	391,906	106,245
Own Source Revenues <sup>5</sup>	1,020,000	1,020,000	721,525	742,835	606,985
Domestic Donations	-	37,073	24,334	31,975	24,465
External Donations	-	90,174	90,171	0	18,080

The final budget was higher than the initial budget by €441,813. This is as a result of the Government Grant of €96,432, Own Source Revenues of €218,134 carried forward from previous year, Domestic Donations of €37,073 and External Donations of €90,174.

In 2016, the Municipality spent €8,846,553 or 96% of the final budget, a lower performance of 1% compared to 2015. Explanations for the current position on budget execution are detailed below.

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

Description	Initial Budget	Final Budget	2016 Outturn	2015 Outturn	2014 Outturn
<b>Spending of funds by economic categories</b>	<b>8,796,498</b>	<b>9,238,311</b>	<b>8,846,553</b>	<b>8,878,415</b>	<b>8,176,752</b>
Wages and Salaries	5,631,323	5,687,613	5,675,925	5,519,858	5,046,011
Goods and Services	808,644	822,706	782,425	810,343	629,647
Utilities	117,000	148,251	145,532	161,046	126,008
Subsidies and Transfers	223,813	264,494	201,391	327,545	168,359
Capital Investments	2,015,718	2,315,247	2,041,280	2,059,623	2,206,727

<sup>3</sup> Final budget - the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

<sup>4</sup> Own Source Revenues unspent in previous year carried forward into the current year.

<sup>5</sup> Receipts used by the entity for financing its own budget.



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Explanations for changes in budget categories are given below:

- The increase of €56,290 in the budget for Wages and Salaries was as a result of Government's Decision;
- The increase of €14,062 in the budget of Goods and Services was as a result of the increase in carried forward own source revenues of €32,872, the budget cut of €8,700 following the budget review and budget cut of €10,110 based on the Government decision;
- The increase of €31,251 in the budget of Utilities was as a result of the budget increase of €8,700 following the review, increase in carried forward own source revenues of €22,923 and budget cut of €372 from the Government;
- The budget of Subsidies and Transfers was increased by €40,681 as a result of carried forward own source revenues of €30,781 and the increase of €9,900 from the Government; and
- The increase of €299,529 in the budget of Capital Investments was as a result of carried forward own source revenues of €131,557, Government decision by €40,726 and donors grants by €127,246.

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#### **Issue 7 – Budget Execution – High Priority**

- Finding** Budget execution was at the expected level in general, except for the lower level in the capital investments (88%) and Subsidies and Transfers (76%).
- Risk** Inadequate budget planning on Capital Investments and Transfer and Subsidies and a low budget execution level will result in a failure to meet organisational objectives.
- Recommendation 7** The Mayor should ensure that budget performance is systematically monitored on a monthly basis and that this review identifies and addresses barriers to planned levels of budget execution. Where initial or reviewed budget assumptions are found to be incorrect this should be fully reflected in the final budget position.

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### 3.1.1 Revenues

The final budget for revenues in 2016 was €1,020,000, out of which €1,061,435 or 104% of the planned budget was spent. Collected revenues mainly relate to property tax, construction permits, rent income, administrative and other fees.

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#### Issue 10 - Leasing of Agricultural Land - High Priority

**Finding** The Municipality has leased municipal agricultural land for use to farmers. The land has been leased in violation of Regulation no. 23/2013 on Determination of Procedures on the Allocation for Use and Exchange of Immovable Property of Municipality by overlooking the public auction, i.e. competition and by setting the lump sum price instead of a regulation-based one.

**Risk** Leasing municipal land without a public auction and on a lump sum price leads to the risk of elimination of competition and prevents the achievement of the highest lease price.

**Recommendation 8** The Mayor should ensure that municipal property is leased according to the Regulation no.23/2013 on Determination of Procedures on the Allocation for Use and Exchange of Immovable Property of Municipality.

#### Issue 9 - Failure to Approve Construction Permits in Time - High Priority

**Finding** The construction permit should be issued by the Urban Planning Department 45 days after submission of proof of payment by the applicant. In one (1) case, the municipality issued it with a delay of 54 days after the stipulated deadline.

**Risk** Urban Planning Department's failure to respond within the statutory deadlines on the approval or refusal of construction permits leads to the risk of constructions without permits to start and prevents the collection of fees from construction permits.

**Recommendation 9** The Mayor should ensure that officers in charge consider all applications in time and issue respective decisions within the statutory deadlines.

**Issue 10 – Failure to Verify the Current Situation of Properties – High Priority**

**Finding** According to the records of property tax sector, the municipality has 10,088 registered properties. In 2016, the Municipality conducted 259 verifications of the existing properties, i.e. it did not manage to verify 1/3 of properties verifications as required by the applicable administrative instruction.

**Risk** Low verification of properties may result in incomplete information on the current immovable property which may potentially lead to lower estimated property tax revenues.

**Recommendation 10** The Mayor should ensure that municipal property is verified as stipulated in the administrative instruction in order to have all eventual changes on properties integrated in the database, which is valid for the taxable basis.

### 3.1.2 Wages and Salaries

The final budget on Wages and Salaries was €5,687,613, whilst €5,675,924 or 100% of the final budget was spent. Wages and Salaries are paid through a centralised system. The key controls that confirm accuracy and completeness of payments are payroll lists signed by the Heads of Units.

#### Recommendations

We have no recommendations in this area or.

### 3.1.3 Goods and Services and Utilities

The final budget of Goods and Services was €822,706, out of which €782,425 or 95% of the final budget was spent. Those mainly relate to expenditures for utilities, travel, telecommunication, services, purchase of mobile phones and equipment, fuel, insurance and registration services, maintenance and other.

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**Issue 11 - Contracts Outside the Procurement Plan and Lack of Committed Funds - High Priority**

**Finding** The procurement plan submitted to CPA by the Municipality did not include the three-year contract on Mobile Telephony Services for Municipal Institutions estimated at €54,640. Moreover, this contract was signed without any funds committed in KFMIS.

**Risk** Entry into contracts outside the procurement plan and lack of committed funds before the contract is signed increases the risk of changes in priorities and leads to failure to execute the contract due to uncertain funds.

**Recommendation 11** The Mayor should ensure that the procurement plan is prepared based on real needs, execution is made in line with planning and that needed funds to execute contracts are committed before the contracts are signed.

**Issue 12 - Entry into Contract with the Ineligible Bidder - High Priority**

**Finding** The municipality had foreseen the provision of 186 new book titles, with a total of 472 in the estimated contract value of €3,000. The cheapest offer was €4,471, or €1,471 higher than the estimated contract value, which means that all other bids were higher than the estimated value. This process had to be cancelled and re-tendered, whilst the municipality reduced the contracted quantity to reach the value of €3,000 and signed the contract.

**Risk** Awarding the contract to the EO having offered a higher value than the estimated one indicates failure to honour the law and may lead the Municipality to the risk of not meeting the needs for such supply.

**Recommendation 12** The Mayor should ensure that the law is adhered to and that contracts are entered into in line with the requirements in the Tender Dossier.

### 3.1.4 Subsidies and Transfers

The final budget of Subsidies and Transfers was €264,494, out of which €201,391 or 76% of the final budget was spent. Those mainly relate to support culture and sport activities or ad-hoc support.

**Recommendations**

We have no recommendations in this area.

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### 3.1.5 Capital Investments

The final budget of Capital Investments was €2,315,247, out of which €2,041,280 or 88% of the final budget was spent. Those mainly relate to rehabilitation of infrastructure, construction of premises, asphaltting of roads, sewerage, equipment, different improvements of capital and others.

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#### Issue 13 - Failure to Apply the Construction Book - High Priority

**Finding** The Municipality did not apply the construction book for the contract "Opening of the road Papare - Gili Kaliqan Field" in the amount of €27,994. The lack of a construction book makes the preparation of progress payments on the real extent of executed works. Therefore, it is not clear whether the payments made are in line with the counter-value of the executed works according to the terms of the contract. The Law no.04/L-110 on Construction and the AI no.15/2013 on Conditions for Maintaining the Construction Diary and Construction Book clearly define the obligation and conditions on how the construction book should be administered and who should be the one to verify it.

**Risk** Failure to apply the construction book and non-verification of progress payments in accordance with the construction book and the contracted quantities increase the risk that the received works may not be executed under the contracted terms and that payments will be made for unfinished stages.

**Recommendation 13** The Mayor should ensure that the construction book is applied when it comes to future progress payments for ongoing or new projects and that it is reconciled with the progress payments in order to verify the accuracy of executed works and amounts of payments. It should be made clear to project managers that future activities should be in line with the Law no.04/L-110 on Construction and the AI no.15/2013 on Conditions for Maintaining the Construction Diary and Construction Book issued by MESP.

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### 3.1.6 Common Issues on Goods and Services and Capital Investments

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

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#### Issue 14 - Misclassification under economic codes - High Priority

**Finding** The Municipality has misclassified expenditures this year as well. They paid €73,850 from the capital investments category based on the agreement entered into with Caritas Kosovo to provide services which had been foreseen in the "Home care and ambulatory care" Project. Moreover, €3,000 were paid from Goods and Services for food packages for families with severe economic conditions, whilst this type of expenditure falls under the category of Subsidies. The amount of €73,850 was approved for Capital Investments in the Law on 2016 Budget.

**Risk** Payments made from the wrong economic categories may result in a misleading view of expenditures, in overstating one category and understating another and in untrue presentation of the AFS.

**Recommendation 14** The Mayor should ensure that during the intimal budget planning, expenditures are planned, incurred and recorded under adequate economic categories according to the Chart of Accounts.

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## 3.2 Assets

### 3.2.1 Capital and Non Capital Assets

In the AFS, the Municipality presented assets over €1,000 in the amount of €12,494,000, whilst those under €1,000 in the amount of €52,000. Issues related to the assets presentation in the AFS are handled in Chapter 1.1 – Audit Opinion.

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#### Issues 15 – Weaknesses in Assets Management - High Priority

**Finding** The Municipality had established the Stocktaking Commissions, but they did not account stocks in the warehouse and Administration’s vehicles. Moreover, the Education Department stocktaking report was prepared in delay, on 08.03.2017.

The stocktaking commissions did not compare the inventory balance with the balance in the non-financial assets register which is a requirement of the Regulation on the Management of Non-Financial Assets in the Budget Organisations.

**Risk** Incomplete and inaccurate assets register and failure to compare the assets register to the current balance makes the confirmation of assets existence difficult and increases the risk that they will be misused, lost or alienated

**Recommendation 15** The Mayor should ensure that assets registers are complete and accurate and that concrete actions are taken for the weaknesses identified during the stocktaking in order to improve them according to the Regulation on Assets Management

### 3.2.2 Receivables

Accounts receivables in the AFS were €862,000. The structure of accounts receivable consists mainly of: property tax, rents and business taxes. Errors in the declaration of accounts receivable in the AFS are handled in Chapter 1.1 – Audit Opinion.

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### 3.3 Outstanding Liabilities

The statement of liabilities not paid to suppliers at the end of 2016 was €188,000. These liabilities are carried forward to be paid in 2017.

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#### Issue 16 - Delays in Paying Invoices and Failure to Report to MoF - Medium Priority

**Finding** According to MoF Financial Rule no.01/2013 on Public Funds Expenditure, Budget organisation has to pay, every valid invoice for the payment of goods and services received, within 30 calendar days, from the day of receiving of invoice. In three (3) cases amounting to €15,095 we found that invoices were paid in delays from four (4) to 13 months.

The Municipality did not report to MoF on outstanding liabilities or invoices of December 2016.

**Risk** Irregular reporting to MoF on outstanding liabilities may lead to failure to meet the requirements under the Financial Rule. Delays in paying invoices increase the risk of the Municipality facing potential lawsuits and damages its reputation towards the economic operators and citizens.

**Recommendation 16** The Mayor should ensure that received invoices are paid within the foreseen statutory deadline and that outstanding liabilities are reported according to the timelines set in the financial rules.

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 were 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.

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*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 1705<sup>19</sup> 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
Financial statements	The Mayor should ensure that effective processes are in place to confirm that the 2016 AFS production plan formally addresses all audit issues raised, including complete recording of all assets. This should also include the review of the draft AFS by the management, with a special focus on areas of high risk/or areas where errors have been identified		There has been progress in the preparation of AFS but complete recording of assets and classification of expenditures still remains a challenge.	
Prior Year Recommendations	The Mayor should strengthen control measures and responsibilities towards officials who are responsible for complete implementation of recommendations, so that the actions foreseen under the Action Plan are implemented, particularly in the areas identified with the greatest degree of risk and within the limits set.			Not implemented
Good Governance	The Mayor should ensure that governance processes are accompanied by strategic plans, risk management, and implementation of procedures, in order to measure results against objectives. In addition, reporting and communication will improve management's ability to respond to potential challenges on time		The strategic plan was prepared but there were setbacks in risk management and reporting.	
	The Mayor should ensure that risks are identified in a register assessing the risk level, the potential that risks might occur and adequate measures as response to them. A senior officer of the Municipality should provide for they are implemented and monitored systematically		There was progress made in the identification of risks, but systematic implementation and monitoring as a response to them still remains a challenge.	

	The Mayor should ensure that a review is implemented to determine the format of financial reporting to senior management, which is required to support effective business management and to ensure that an appropriate solution is in place			Not implemented
Internal Audit	The Mayor should discuss an action plan with other management levels, assign staff responsible, and determine deadlines to address recommendations given by the internal audit. In addition, should be established process for monitoring of progress. When identified issues that need handling, the IAU are should focus more on current year activities, by giving a priority to areas where the risk level is considered high.		Implementation of IAU plan and focusing of IAU activities on the current year still remain a challenge.	
Procurement expenditures	The Mayor should ensure that a review is conducted to determine why the procurement requirements were not consistently applied on the abovementioned cases, by not evading procurement procedures, and design specific projects before initiating procurement procedures	Implemented		
	The Mayor should review why procurement requirements were not implemented in the abovementioned cases and apply additional controls to ensure that such situations are not repeated in the future		There was progress but implementation of more controls to eliminate procurement weaknesses still is to be done.	

Non-procurement expenditures	The Mayor should ensure that upon co-financing in the future, it will be an active and equal party in terms of follow up, implementation and oversight of these projects. Practices such financing and payments made under these agreements should be stopped, and instead insist that all payments are made only after the receipt of services and based on invoices and to the progress of the agreements, and no prepayments., further, contracts for special services are used for specific purposes where really no shortage of staff as well as their duration do not be over 6 months as defined by the law. We suggest that such practices are not repeated			Not implemented
Remunerations (Wages and Salaries)	The Mayor has to look into this issue and determine why have these irregularities occurred in the process, and have been repeated for years, and to ensure that in the payroll system will not be processed payments based on fictive contracts			Not implemented
Subsidies and Transfers	The Mayor should ensure that upon subsidising farmers an objective and transparent process is applied based on clear and measurable criteria.	Implemented		
Revenues	The Mayor should ensure that verification of municipal property is done as foreseen under the law, so that all potential changes of properties that are valuable to the taxable base are integrated in the database. Furthermore, additional actions are undertaken to ensure that deductions of €10,000 are applied in line with Article 9 of the Law on Taxes on Immovable			Not implemented

	The Mayor should ensure that public auctions are organised when leasing municipal property, in order to have an open and transparent process, and to increase mechanisms and exercise constant monitoring over the use of public spaces, so that they are not used prior to meeting obligations in line with the municipal Regulation			Not implemented
Capital and non-capital Assets	The Mayor should ensure drafting of an internal guideline on assets management wherein roles and duties of certain officials who have to contribute to preparation of data on assets that need to be recorded are clarified, and then all assets are correctly presented in the AFS. To ensure that adequate controls are applied to ensure that vehicles are used for official purposes			Not implemented
Accounts receivable	The Mayor should ensure that the removal of Accounts Receivable from the AFS will be conform to legal requirements wherein procedures will be established clearly as well as the manners in which they are paid off. Furthermore, to ensure that Accounts Receivable are presented correctly in the AFS	Implemented		
Accounts payable	The Mayor should ensure that the reporting of outstanding liabilities is done in the Treasury on monthly basis and are undertaken measures so that that invoices are paid within the legal deadlines		Measures were taken when it comes to paying invoices within the legal deadline, but reporting on outstanding liabilities remains a challenge.	



## Annex IV: Letter of Confirmation.

*[Put the Municipality's logo]*

### LETTER OF CONFIRMATION

For having agreed on the Auditor General's findings of 2016 and implementation of recommendations:

To: National Audit Office

Venue and date:

Honoured,

We hereby confirm that:

- We have received the draft audit report of the National Audit Office on the 2016 Annual Financial Statements of the Municipality of Istog, hereinafter referred to as the Report;
- Agree on the findings and recommendations and I have no comment on the content of the Report; and
- Within 30 days from receiving the final report, I will submit the action plan on implementation of recommendations including the deadlines and responsible staff for their implementation.

Mayor:

XXXXXX



Republika e Kosovës  
Republika Kosova  
Republic of Kosovo



Komuna e Istogut  
Opština Istok  
Istog Municipality

DATË/DANA:	15.06.2017
REFERENCË/PREPORUKA	01Nr.351/17
PËR/ZA/TO:	Zyrën Kombëtare të Auditimit
CC:	
PËRMES/PREKO/THROUGH:	
NGA/OD/FROM:	z. Ilak Rugova, Kryetar
TEMA/SUBJEKAT/SUBJECT:	Konfirmim për pajtueshmërinë me të gjeturat e Auditorit të Përgjithshëm për vitin 2016 dhe për implementimin e rekomandimeve

Te nderuar,

Përmes kësaj shkrese, konfirmoj se:

- kemi pranuar draft-raportin e Zyrës Kombëtare të Auditimit për auditimin e pasqyrave financiare të Komunës së Istogut për vitin 2016 (në tekstin e mëtejshëm "Raporti");
- pajtohemi me të gjeturat dhe rekomandimet dhe nuk kemi ndonjë koment për përmbajtjen e raportit, si dhe
- brenda 30 ditëve nga pranimi i raportit final, do t'ju dorëzojmë një plan të veprimit për implementimin e rekomandimeve, i cili do të përfshijë afatet kohore dhe stafin përgjegjës për implementimin e tyre.

Me respekt!