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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 MITROVICA
NORTH MUNICIPALITY 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 Mitrovica North Municipality 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 Xhevat Seferi - Team Leader and Nebojsa Ristic team member under the management of the Head of Audit Department Zukë Zuka.

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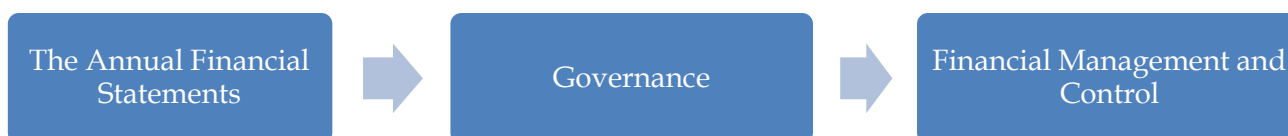
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Executive Summary

Introduction

This report summarises the key issues arising from our audit of the 2016 Annual Financial Report of the Mitrovica North 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 Plan¹ dated 21.10.2016.

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

Qualified Opinion with Emphasis of Matter

In our opinion, the Annual Financial Statements for the year ended on 31st of December 2016 *present a true and fair view* in all material respects, Besides the advance payment for capital investments in the amount of €175,775, exceeding the ceiling specified (over 15%) by the 2016 Budget Law.

Emphasis of matter

The Municipality did not record and disclose in the Annual Financial Statements all assets purchased in 2016 including the land and buildings owned.

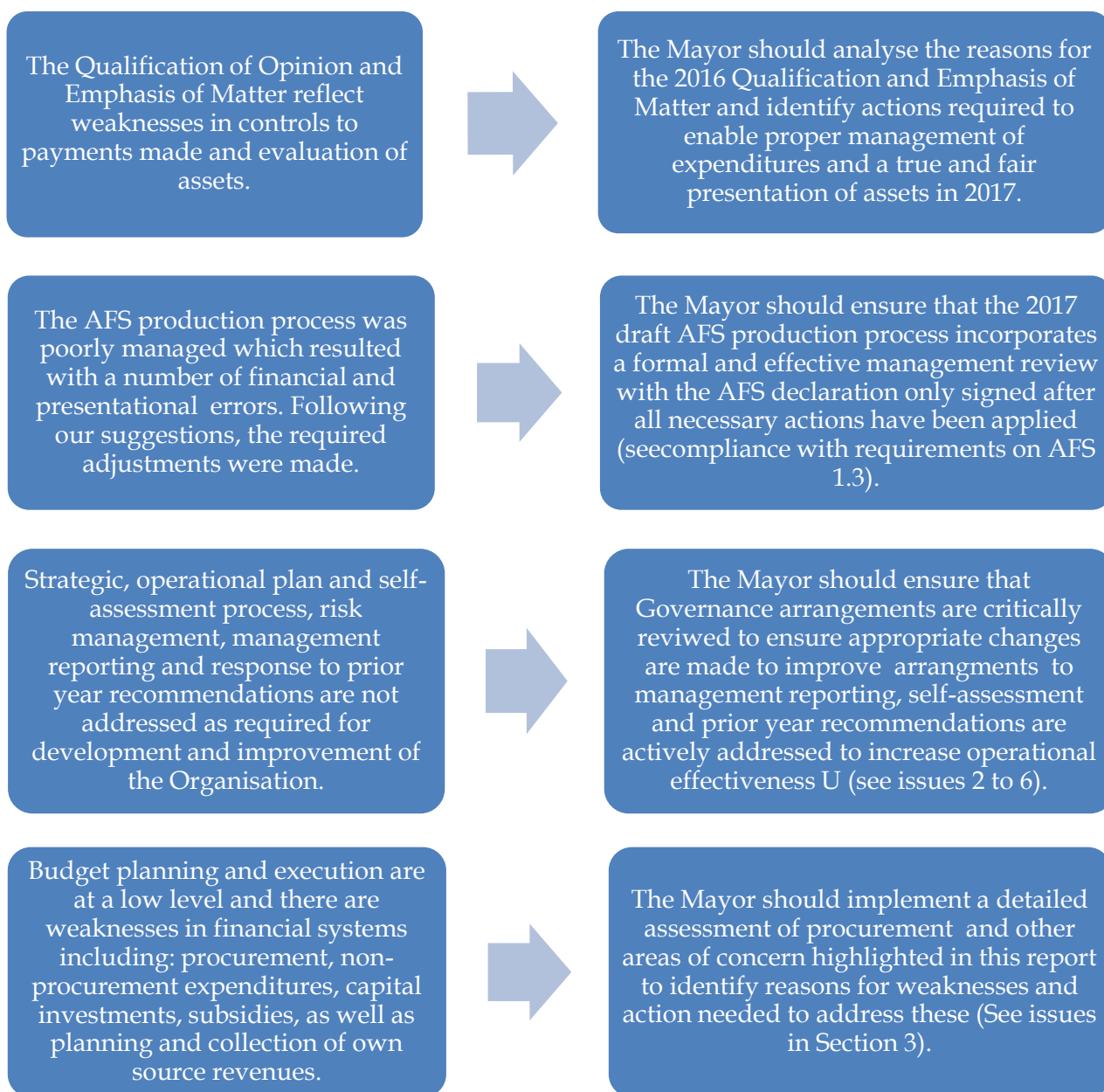
For more, please refer to Section 1.2 of this report.

Annex II 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



Response of the Mayor

The Mayor has taken into account and is reconciled with the detailed audit findings and conclusions, and is committed to address all recommendations given.

Furthermore Mayor is committed to:

- Review Audit Report at the Municipal Assembly; and
- by the end of January 2018, to discuss in the Municipal Assembly the progress regarding the implementation of the Action Plan on Audit Recommendations, before the PFV 2017 have been 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 Administrative Officer and Chief Financial Officer when the 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

Qualified Opinion with Emphasis of Matter

We have audited the AFS of the Mitrovica North Municipality 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, except for the effects of the described in the Basis for Qualified Opinion paragraph, the 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 by the Ministry of Finance.

Basis for Qualified Opinion

For the contract "Support to the Development of Small and Medium Enterprises" signed on 19.07.2016 in the amount of €399,489, it was foreseen that the funds are provided from the "Development Fund"., The Regional Development Agency - North (RDA) has been contracted for the implementation of this project. On 25.07.2016, a request for transfer (advance payment) was made in the amount of €179,489. The Municipality has carried out the transfer on 05.08.2016 in the amount of €175,775 only on request from RDA, exceeding the allowed limit for granting advance payment (15%).

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. NAO is independent of the Municipality in accordance with the ethical requirements that are relevant to our audit of the annual financial statements of Budget Organisations in Kosovo and we have fulfilled other ethical

responsibilities in accordance with these requirements. 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 that the Municipality failed to disclose the exact and full values of municipal assets in the AFS of 2016. There are including educational facilities, as well as purchases of books for the library. This is because the Municipality did not finalise the asset inventory and valuation process.

Responsibility of the Management and Those Charged with Governance and AFS

The Management of the Municipality 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.

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 Organisation 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;
- Other budget reporting requirements, such as quarterly reports, including the nine-month statements in time; Operational (performance) reports if any; and
- Draft and final procurement plan in time.

In the context of the AFS issues related to reporting framework have not been addressed when preparing draft Financial Statements where we identified the following non-compliances:

- Article 13. Statement of Cash Receipts and Payments;
- Article 14 Budget Execution Report; and
- Errors in section of disclosure and notes: 15, 19, 21, 22, 24, 26 and 28.

Following our suggestions, a number of financial adjustments were made, in addition to article 19 regarding the accurate evaluation and disclosure of capital, non-capital assets and inventory of consumables. These issues form the basis for emphasis of Matter.

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 correct, except the issues raised in the Audit Opinion.

In the context of other external reporting requirements we have no issues to raise on these matters.

1.3 Recommendations for the first part of the report

Recommendation 1 The Mayor should ensure that an analysis is undertaken to determine the causes of the Qualification and Emphasis of Matter. Actions should be taken to address the underlying causes in a systematic manner to remove errors in of advance payment, and management, recording and accurate valuation of assets. This should include Management review of the draft AFS with specific focus on high risk areas and/or areas where errors have been identified in previous years. The Declaration made by the Chief Administrative Officer and Chief Financial Officer should not be submitted unless all necessary checks have been applied to the draft AFS.

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 BOs 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 s 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 and risk management were not completed by the Municipality. Furthermore, other arrangements which would support the development of governance such as an effective response to audit recommendations and the operation of a high quality internal audit unit are not in place.

In 2016, the Municipality used 84% of its final budget, an improvement of 5% compared with the previous year. This shows a positive trend in the budget execution.

However, when it comes to compliance with legislation, our audit has disclosed weaknesses, including mainly procurement, as a result of failure to apply procurement regulations, lack of Regulation on granting subsidies and the Regulation on collection of revenues. The audit report was not discussed in the Municipal Assembly, as required in previous year report.

2.1 Progress in the Implementation of Prior Year Recommendations

Our Audit Report on the 2015 AFS of the Municipality resulted in 14 recommendations. The Municipality prepared an Action Plan stating how all recommendations will be implemented. The audit report was not discussed in the Municipal Assembly, as requested through the previous year report.

At the end of our audit, two (2) recommendations have been implemented; four (4) are in process of being addressed; and eight (8) have not been implemented 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 From the paragraph above we can see that most of prior year recommendations have not been implemented because the Municipality has not implemented any formal process to manage and monitor the actions taken in implementing the Auditor General's recommendations.

Risk Failure to fully implement the recommendations resulted particularly in:

- Poor quality in contract management for works on capital projects; and
- Weakness in implementing procurement regulations, lack of internal regulations for granting subsidies and collection of revenues.

Recommendation 2 The Mayor should strengthen the control and accountability measures against persons in charge to fully address the recommendations that the actions foreseen in the action plan are implemented and receive regular reports on the progress of the recommendations against the action plan.

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 noticed that self-assessment checklist was not completed by the Municipality. The assessment of questionnaire by our side is not intended to give a commentary on the quality of the whole self-assessment questionnaire 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 As part of our audit we have considered whether the self-assessment checklist is completed and we found that:

- The Self-Assessment questionnaire is not completed by the Management of the Municipality confirming that required risk management systems were not in place yet. This situation has arisen because initial positive steps in this area were not undertaken;
- Effective monitoring processes and comprehensive development strategy (involving stakeholders and ensuring a fully costed strategy) were not put in place by the Management of the Municipality; and
- Links between the procurement plan and budget and the production of adequate reports on a timely basis were not put in place and reports were not always produced on a timely basis.

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 an action for completing the self-assessment checklist and proactively addressing areas of weaknesses is undertaken in proactive way. Following this, a revised mechanism to confirm the accuracy of the return and to ensure supporting documentation supports the submission should be applied. We suggest that after the completion of the self-assessment questionnaire, the final quality and accuracy check is made by the internal auditor before submitting it to the Ministry of Finance.

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 (the Municipality) are obliged to prepare and submit organisation level strategic plans such as: Urban Plans, Spatial Plans, Emergency Operations Plans, Anti-Corruption Strategic Plans, Regional Development Strategy etc.

Issue 4 - Lack of Strategic Plans - High Priority

Finding The Ministry has no overall strategy of objectives and other operational plans in place, no strategic development plan, or operating plans such as: urban , spatial plan, etc.

Risk Lack of overall strategic objectives and other development plans makes the follow up on objectives' achievement impossible in the light of the Municipality's vision, as one of the essential requisites of good governance.

Recommendation 4 The Mayor should ensure that an overall development strategy is drafted as well as an action plan to monitor the achievement of objectives by establishing effective oversight functions.

2.3.2 Management Reporting and Accountability

A range of internal controls are applied by the 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.

Issue 5 - Weaknesses in High Level Management Controls - High Priority

Finding Our review of the management controls applied to Municipality's key financial system highlighted that despite all improvements in financial reporting of expenditure and revenue to senior management, quality of reporting is not yet at a satisfactory level 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 has reduced the management's ability to proactively manage the operations of the Municipality and undermines effective budgetary control. This can result in unplanned over or under spending and delay necessary actions to address these. Similarly, it may result in poor quality service delivery.

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.

2.4 Internal Audit System

Budget Organisations are obliged to ensure that its activities and processes are subject to internal audit. A proper internal audit system assist the Management in identifying weaknesses in financial management and controls of the Municipality. This adds value to the quality of operational activities and contributes to achieving the objectives and improving the services provided by the Municipality.

Issue 6 – Failure to establish the Internal Audit Unit (IAU) - High Priority

Finding The Municipality did not yet managed to establish the Internal Audit Unit or the Audit Committee. This because the Management does not pay attention to the role and benefits it may have from these services. Recommendations regarding the need to establish this Unit by the NAO are being given for years, but the situation continues to be the same.

Risk Lack of regular internal audit reviews may affect the weaknesses being repeated in key internal control systems. Furthermore, the Management may not be able to timely identify weaknesses of controls and react to eliminate them.

Recommendation 6 The Mayor should consider establishing the IAU which through a comprehensive work program would incorporate financial and other risks of the Municipality and assess the effectiveness of internal control. In addition, we suggest establishing an effective Audit Committee which should critically review the internal audit plans and outcomes.

3 Financial Management and Control

Introduction

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

Financial Management and Control Conclusion

Regarding the Municipality, procurement remains challenging because the regulations are not being implemented, resulting in poor value for money as well as delays in project completion. In the context of financial systems, controls over a range of expenditure areas require further improvement. The main areas where more improvements are needed are budget execution, especially for the capital investment category and revenue planning and collection.

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
Revenues collected by the Municipality	90,000	114,100	44,005	27,400	20,532
Total	90,000	114,100	44,005	27,400	20532

When it comes to planning, the collection of own source revenues seems to be low and this shows a poor performance for the Municipality. However, compared with previous years, there is a slight increase in revenue collection. This increase relates to collection of a construction license amounted to €19,568.

Regardless of carrying forward revenues from the previous period and collection during the current year, the Municipality did not make any expenditure from these sources.

Table 2. Sources of budgetary Funds (in €)

Description	Initial Budget	Final Budget ²	2016 Outturn	2015 Outturn	2014 Outturn
Sources of Funds	4,598,609	6,771,782	4,413,590	2,795,946	4,427,037
Government Grant -Budget	4,508,543	3,662,081	2,096,180	2,604,114	4,402,433
Carried forward from previous year ³ -	0	15,089	4,498	7,500	12,660
Own Source Revenues ⁴	90,066	114,100	8,023	12,682	11,944
Development Trust Fund	0	2,031,619	1,441,201	0	0
External Donations	0	948,893	863,688	171,650	0

The change of the final budget compared with the initial one was increased by €2,173,173. This change is a result of the budgeting from Development Fund (2,031,619), external donations (948,893), changes in own source revenues for 2016 and budgeting of revenues carried forward (39,123) and reductions in government grants (846,462).

In 2016, the Municipality used 65% of the final budget or €4,413,590, an improvement of 18% compared with 2015. However, the budget execution remains at an unsatisfactory level and the current position is explained below.

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	4,598,609	6,771,782	4,413,590	2,795,946	4,427,037
Wages and Salaries	3,646,989	1,870,884	948,899	1,355,094	3,173,582
Goods and Services	285,139	949,424	897,398	775,147	369,630
Utilities	125,000	22,349	22,349	21,440	20,642
Subsidies and Transfers	90,000	164,795	137,195	171,862	67,166
Capital Investments	451,481	3,764,330	2,407,749	472,403	796,017

Explanations for changes in budget categories are given below:

- The capital investment budget was increased by €3,312,849 as a result of implementing the Trust Fund and external donations. This is due to the delayed allocation of funds from the

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.

Development Fund. The Public Investment Program includes ongoing projects from the past year and new projects for the current year and subsequent years;

- Reduction of the budget for wages and salaries by €1,776,105 is the result of failure to pay salaries in the education sector; and
 - Changes in the budget for services, utilities and subsidies were made under budget review.
-

Issue 7 - Budget Execution - High Priority

Finding Budget execution was not at the expected level, and because of poor budget controls, over 1/3 of budget funds have resulted in surplus. This happened because of poor planning and not based on certain objectives. Poor budget performance is mainly seen in capital investments. Despite improved revenue planning, collection policies have been quite poor, and as a result, only 39% of the own source revenue plan was implemented.

Risk Inadequate budget planning and a low budget execution level will result in a failure to meet organisational objectives and result in current year obligations being funded from future year budgets.

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 budget assumptions are found to be incorrect this should be fully reflected in the final budget position.

3.1.1 Revenues

Revenues generated by the Municipality in 2016 totalled €44,005. Sources of collection of own source revenues are limited to these categories: administrative fees and fees on birth certificates, marriage and death certificates. The Municipality is not yet collecting revenues from property tax, construction licenses, and the use of public properties.

Issue 8 – Challenge in Management of revenues – High Priority

Finding Our testing found that the Municipality did not set up a system for managing own source revenues. As a result of the lack of this system, the following shortcomings were presented:

- The Municipality is not implementing the Law on Property Tax and the Law on Construction. Consequently, it failed to collect revenues from property tax, while when it comes to construction licenses, it has issued only one construction license collecting tax in the amount of €19,568, therefore the level of collecting of own source revenues is very low; and
- The Municipality still collects revenues based on a decision from UNMIK time. Furthermore, this decision does not foresee revenues from property tax, construction licenses, the use of public properties or other sources of municipal revenue. Despite recommendations given in this area, the management of the municipality did not yet adapted and approved a new regulation on taxes, charges and fees with the applicable legislation. According to the municipality, the regulation is in process of its drafting to be sent for approval to the Municipal Assembly.

Risk Failure to align new regulation with the legislation in force and the failure to implement the laws on collection of taxes and fees for construction licenses by the municipal management reflects an inadequate management approach to benefit from the services provided and increase the level of revenues, but also the safety and well-being of society.

Recommendation 8 The Mayor should ensure that a policy review is undertaken for putting in place an appropriate system to support revenue collection and management. In addition to drafting of the regulation on taxes, fees and charges, it should ensure that the Law on Property Tax and Law on Construction are implemented, which primarily aims to establishing minimum requirements for the protection of public health, safety and well-being by preserving the structure of space and the environment. Future planning should be based on the capacities and the realistic base of the revenue collection.

3.1.2 Wages and Salaries

Wages and Salaries are paid through a centralised system. The key controls that confirm accuracy and completeness of payments are: (a) Checking payments each month by updating and signing the payroll, (b) checking any possible changes that may appear on the forms, (c) budget review for that category and reconciliation with the Treasury. The final budget for Wages and Salaries in 2016 was €1,870,884, out of which €948,899 or 51% were spent.

Issue 9 - Weaknesses within management of personnel - High Priority

Finding Despite significant improvements in personnel management, the Management has not yet managed to apply controls effectively, as required by current law and regulations. Our audit confirmed the continuation of some of the following weaknesses:

- Management did not yet establish an organizational structure, systematisation of job positions and its alignment with the needs and budget of the Municipality. This had an impact on some key job positions which were not covered with staff; and
- The Municipality paid €16,640 for five employees who were contracted for specific services. However, based on positions and engagement period, these positions are considered regular⁵. Within the geodesy directorate, an officer is held under agreement for specific services from 2013 and is still ongoing. According to the Municipality, this has happened because it was impossible to approve it under a budget.

Risk Covering regular positions with special service contracts for years is not in line with regulations and increases the insecurity of staff for having long-term perspective towards these positions, which may also reflect on poor performance and monitoring of staff. On the other hand, in the absence of an organizational structure, the management will not be able to align the staff needs with the municipal budget.

Recommendation 9 The Mayor should ensure that appropriate actions are taken to address these issues in order to review the real needs for engaging employees with special service contracts. Such cases should be discussed with MoF giving the reasons for the positions needed and the same ones are foreseen in the budget approvals. On the other hand, actions should be taken to design and approve organisational structure and systematisation of job positions.

⁵ Geometer, Economic Development Officer, Administrative Assistant, Education Officer, Database Officer.

3.1.3 Goods and Services and Utilities

The final budget for Goods and Services in 2016 was €949,424 and €22,349 for utilities i.e. a total of €971,773. Out of them, €919,747 were spent. They relate to supply with equipment and inventory, office supplies, contractual services, fuel etc.

Issue 10 - Avoiding Open Procurement Procedures - High Priority

Finding From reviewing procurement contracts, we have identified frequent application of price quotation procedures and minimum purchases under €1000 for similar contracts. In particular, management controls were not operating effectively to ensure the use of proper procurement procedures in the following cases:

- Purchase of Computers and Computer Equipment in total value of €55,684 was divided into two (2) medium contracts. For medical equipment, the Municipality made six (6) purchases with a minimum value of € ,960. All these purchases were made in December; and
- Price quotations and five (5) purchases with minimum values below €1000.

Risk The use of a minimum purchase procedure and price quotations which can be carried through by using an open procedure increases the risk for poor value for money, reduces competition and may be subject to fraud.

Recommendation 10 The Mayor should strengthen controls with aim to assess procurement throughout the year more efficiently in order to avoid dividing tenders of the same nature and have better prices and better quality works/goods at the same time, reducing the expenditures related to tendering processes.

Issue 11 - Weaknesses in receiving and distributing goods – Medium priority

Finding In six (6) separate cases for different purchases in the total amount of €81,175, the Municipality failed to establish a committee for receiving the goods, but the same were received by the project manager. Books purchased for the city library in the amount of €17,500 were not recorded in the asset registers.

Risk Due to poor internal controls it may happen that what is paid is not actually received and result in poor value for money. Furthermore, failure to record purchased assets may result in their alienation and physical loss.

Recommendation 11 The Mayor should establish adequate internal controls to ensure value for money and what is paid is actually received and used by the Municipality so that services to citizens are improved. Further on, he should ensure that the purchased assets are recorded in the municipal assets register.

3.1.4 Subsidies and Transfers

The final budget for subsidies and transfers for 2016 was €164,795 whilst €137,195 was spent. These are mainly allocated to public entities, non-public entities and individual beneficiaries. Examples of subsidies are scholarships for students and pupils, subsidies for sports, social assistance, subsidies in agriculture, etc.

Issue 12 - Management of allocating subsidies - High Priority

Finding We have confirmed that the Municipality has not yet produced a Regulation defining the criteria and procedures for allocation of subsidies. In the 11 tested samples amounting to €70,847 for allocating subsidies, no criteria was found for the way those funds were given and used. Out of all reviewed samples, we found that the subsidy beneficiaries in none of the cases have sent feedback on how those funds were used.

Risk Lack of regulation on subsidies increases the risk of subsidies being given without any criteria and also poses a risk for poor value of money and failure to use financial means for the intended purpose.

Recommendation 12 The Mayor should ensure that a draft regulation on the allocation of subsidies is prepared by the end of 2017, which will be submitted to the Municipal Assembly for approval. In this regulation, the criteria for giving subsidies and mechanisms on how they will be monitored and managed are clearly defined.

3.1.5 Capital Investments

The final budget in 2016 for capital investments was €3,764,330, whilst €2,407,749 or 64% was spent, mainly for investments in road infrastructure, capital facilities in health sector, education etc. The Municipality financed its projects from Government Grant Funds (€490,468), Special Development Fund (€1,441,201) and donations (€476,080).

Issue 13 - Entering into obligations without having funds committed - High Priority

Finding In the one-year framework contract “Supply with medical equipment for the needs of health institutions in Northern Mitrovica”, signed on 27.07.2016 are planned expenditures in the amount of €88,500. However, based on this, the Municipality made a one-time supply of €105,100 using 30% possibility of tolerance for framework contracts. On the other hand, for the additional value (€16,600), funds were not committed. At the same time, the decision on the additional order was taken by the Project Manager and not by the Officer within the Contracting Authority who signed the contract, who is a person responsible for changes in terms of the Contract as required by the Operational Guidelines for Public Procurement⁶.

Risk The mentioned shortcomings have an impact on executing such supplies. Failure to specify details of what and how much the supply should be, and entry into obligations without having funds committed can put the Municipality into a difficult budget position. Such projects may result in poor value for money.

Recommendation 13 The Mayor should ensure that a review of audit findings has been undertaken for these cases where processes have not been effectively applied to determine why the failures occurred and why appropriate oversight has not been applied. The Mayor should bear in mind the value for money especially for costly capital projects. Further on, the Mayor should take measures to eliminate these weaknesses so that such contracts are not allowed in the future.

⁶ Operational Guidelines - point 55.22 - Where the contract is amended in order to change the original terms and conditions, the amendment to the contract shall be prepared by the Procurement Department.

Issue 14 - Avoiding Open Procurement Procedures - High Priority

Finding From reviewing nine contracts for the maintenance of sewage systems and the changing manholes in the amount of €25,240, we have identified that procurement was carried out according to procedures with minimum values or price quotations without using open procedure for similar work. Under these circumstances, the Municipality could have had a framework contract for the maintenance of infrastructure.

Risk The use of minimum value procedures or price quotations for expenses that can be made using an open procedure increases the risk of poor value for money, reduces competition and does not meet certain objectives.

Recommendation 14 The Mayor should strengthen controls with aim to assess procurement throughout the year more efficiently in order to avoid dividing tenders of the same nature and have better prices and better quality works/goods at the same time, reducing the expenditures related to tendering processes.

Issue 15 - Other Procurement Weaknesses - Medium Priority

Finding For 5 signed contracts⁷ (€1,562,407), the Municipality failed to prepare a contract management plan.

Risk Lack of a contract management plan may affect in failure to execute contracts under defined terms and with improper payments.

Recommendation 15 The Mayor should ensure that a review has been carried out to determine why in the above cases the procurement requirements and financial rules have not been implemented consistently. Consequently, controls should be strengthened to ensure similar situations are not repeated in future procurements.

⁷ "Construction of the Fire fighter Brigade" (€594,481), "Construction of the Sports Hall" (€ 860,138), "Supply with medical equipment for the Health Centre in Mitrovica N." (€ 88,500), "Revitalization of the entrance to the facility, the street Tanasko Rajic no. 2 in Mitrovica North" (€9,572) and " Revitalization of the entrance to the building on Sutjeska Street no. L1 in Mitrovica North "(€ 9,715).

3.2 Assets

3.2.1 Capital and Non Capital Assets

Capital assets are all assets owned by the Municipality with a cost over €1,000, whilst non-capital assets are worth less than €1,000. Asset management in the Municipality of Mitrovica North compared with previous years made progress. The Municipality appointed an asset management officer and after our suggestions in December 2016, the committee for asset registration was established.

Issue 16 - Identification, Registration and Asset Management - High Priority

Finding Despite the progress in asset recording and management, the Municipality still faces challenges with asset management. The Municipality recorded the assets purchased in 2016 in its accounting records, but not the assets of previous years. From the sample we have reviewed, in the asset registers is observed that the educational facilities, libraries and purchased books for the library, were not present in the asset registers and not included in the AFS disclosures. Assets under €1,000 are not recorded in the e-assets system.

Risk Failure to fully record assets in internal registers and KFMIS results in failure to fairly and factually present the assets. Further on, this situation increases the risk of loss, alienation or even mismanagement of assets.

Recommendation 16 The Mayor should analyse the reasons for not recording all assets in 2016 and those of previous years. The Mayor should ensure that the work carried out by the Asset Recording Committee is systematically monitored and, if required, additional actions are undertaken to confirm the completeness and accuracy of assets values in the AFS of 2017 and onwards. In addition, the process of recording assets and other unregistered properties should continue, and the asset recording officer should guide this process. Further on, in order to have accurate stock records, all inflows/outflows of movable property under €1,000 should be made through the e-assets system.

3.2.2 Handling of Cash and Cash Equivalents

Petty cash is a small fund of money kept in custody and control of the Budget Organisation, department or smaller budget units depending on budget appropriations and are used to cover small value expenses (up to €100).

We have no recommendations in this area.

3.3 Outstanding Liabilities

The statement of outstanding liabilities against suppliers at the end of 2016 was €23,117. These liabilities were carried forward to be paid in 2017. However, this reflects only a part of the Municipality's budget difficulties encountered by our audit.

Issue 17 - Inadequate management of obligations - Medium Priority

Finding From our audit we noticed that during 2016 the Municipality did not maintained an adequate protocol book of receipts given that the received receipts are not recorded under a protocol number.

Risk Insufficient financial controls for unpaid municipal liabilities, non-implementation of financial rules may result in unplanned payments for future municipal budget and/or double payments. This may lead the Municipality to budgetary difficulties and failure to reach its annual operational objectives.

Recommendation 17 The Mayor should strengthen controls over receiving receipts and their payment within the legal deadline to ensure that the finance department will establish an effective system and that all unpaid invoices are recorded in the receipt book.

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 s 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 s identified at the interim audit where they remain relevant. Our findings are defined as:

High Priority - s 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 - s 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 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
1.5. Financial statements	<p>Recommendation 1. The Mayor should ensure that an analysis is undertaken to determine the causes behind presentation of AFS with errors, why the external reporting requirements have not been implemented, and why assets were not fully recorded. Action should be taken to address the underlying causes in a systematic and pragmatic manner in order to prevent 2016 AFS from containing errors and to ensure correct recording and disclosure of municipal assets.</p> <p>Recommendation 2. The Mayor should ensure that effective processes are in place to confirm that the 2016 AFS production plan formally addresses all compliance issues. This should also include the review of the AFS by the management, with specific focus on high-risk areas and/or areas where errors have been identified in previous years. The Declaration made by the CAO and CFO should not be submitted unless all necessary checks have been applied to the draft AFS. The Mayor should look into the need to train the financial staff, with particular focus on those directly involved in preparation of the AFS.</p>	Recommendations 1 and 2 have been implemented since the AFS have been revised in relation to the audit opinion, except the full disclosure of the assets.		
2.3 Prior Year Recommendations	<p>Recommendation 3. The Mayor should ensure that within 30 days from the finalisation of this report, an action plan setting forth specific measures and actions needed to address given recommendations is prepared. The plan also needs to determine the staff responsible and the deadlines within which appropriate action will be taken, with the key focus on the areas that contain a higher degree of risk. A continuous process of monitoring should also be part of this plan. The Mayor should initiate discussion of the audit report in the municipal assembly.</p>			No measures were taken. Only two out of 14 recommendations of last year have been implemented.

2.4 FMC Self-Assessment Checklist.	Recommendation 4. The Mayor should ensure that the self-assessment checklist for 2016 will be completed and submitted to the MoF. Prior to submission to MoF it needs to be reviewed and the answers provided confirmed. The Mayor should also initiate activities for preparation of a municipal strategy, which should be ready for implementation starting from 2017. This strategy should be accompanied by a cost that corresponds to municipal resources and effective mechanisms that ensure its implementation and achievement of results.			No measures were taken. Municipality has not completed self-assessment checklist.
2.5.1 Risk assessment	Recommendation 5. The Mayor should ensure that identification, risk assessment and measures to reduce the risk to an acceptable level are reviewed at the highest levels of management. Furthermore, the Mayor should ensure that the risk management responsibility is directly delegated to a director, who in coordination with heads of units will manage this process and will report on risks on regular basis.			No measures were taken. The Municipality does not yet have a list of risks, as well as a plan for managing and reducing risks at acceptable levels.
2.5.2 Management Reporting	Recommendation 6. The Mayor should ensure that a review is implemented to determine the format of financial reporting to the senior management which is required to support effective business management and to ensure that an appropriate solution is in place by the end of 2016.		The Municipality still has weaknesses in financial reporting on expenditures and revenues to senior management.	

2.6 Internal Audit System.	Recommendation 7. The Mayor should take into consideration recruitment of an internal auditor, who through a comprehensive work program would incorporate financial and other risks of the municipality and assess internal control effectiveness. In addition, we suggest establishment of an effective Audit Committee, which will critically review plans and internal audit results.			No measures were taken. The Municipality has not yet managed to establish the Internal Audit Unit as well as the Audit Committee.
3.2 Planning and budget execution.	Recommendation 8. The Mayor should analyse causes behind budget performance setbacks in certain economic categories. The Mayor should ensure that budget planning reflects the needs and capacities of the municipality, and to monitor systematically execution against planning.		The Municipality still has poor performance of budget execution.	
3.3 Procurement Issue 7 - Avoiding Open Procurement Procedures	Recommendation 9. The Mayor should strengthen controls in order to achieve a more efficient assessment of procurement during the year, so that is avoided splitting of tenders of the same nature, and to achieve better prices and better quality works/goods, whereby reducing the associated costs for tenders processes.			No measures taken. There are still separations tenders of the same nature.
3.3 Procurement Issue 8 - Other Procurement Weaknesses	Recommendation 10. The Mayor should ensure that is carried out a review in order to determine why in the abovementioned cases the procurement requirements and financial rules were not applied consistently. Consequently, the controls should be strengthened to ensure that such situations are not going to be repeated in the future.			No measures taken. The weaknesses of the past years have been repeated.
3.3 Procurement Issue 9 - Weakness in Tender Dossiers	The Mayor has to strengthen controls over procurement to Recommendation 11. ensure full compliance with legal and financial requirements, with particular emphasis on clear definition of the value and quantity of supplies under the contract.			Procurement procedures are not yet fully in line with legal and financial requirements.

3.4 Expenditure not related to Procurement 3.4.1 Remunerations (wages and salaries)	Recommendation 12. The Mayor has to strengthen controls relating to personnel in order to ensure that the number of personnel is in line with the law and that all salaries will be recorded in adequate codes. The decision to suspend employees should be reviewed and taken formal actions that ensure sufficient quality services, education and health for citizens. The Mayor should ensure that by September 1, 2016, all personnel files are completed with all the documentation required under the applicable regulations.		The decision to suspend employee salaries in education and health has not been reviewed.	
3.5 Revenues (including own source revenues)	Recommendation 13: The Mayor has to analyse the reasons behind for such a low level of revenue collection and to enhance controls in order to ensure a proper planning that is based on realistic analysis. The mayor has to address the efficiency of revenue collection in general, by also applying the collection of property taxes and fees for construction permits.			The Municipality has not yet approved a regulation on taxes, fees and charges. Also not all types of taxes and fees are collected.
3.6.1 Capital and non capital Assets	Recommendation 14: The Mayor should ensure an effective recording process of all assets, by determining key roles that can be played in this process by the Directorate of Cadastre, by collecting and reporting all the data on assets owned by the municipality. Subsequently, a special committee should conduct an assessment of assets identified and after a critical review by the Mayor, a report should be submitted to the assets officer to enter adequate recording into the KFMIS system (assets module). In addition, the committees for assets inventory and evaluation should be established every year at an adequate time in order to conduct a complete inventory so as to confirm the existence of assets (particularly movable). All activities should be carried out before submitting AFS for 2016 to the MoF.		Despite the progress achieved in asset management Assets registers are not yet complete.	
Number of recommendations:		2	4	8

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: 31.05.2017

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 North Mitrovica, 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:

Goran Rakic



Republika e Kosovës
Republika Kosova-Republic of Kosovo
Qeveria - Vlada - Government

Opština Severna Mitrovica
Komuna e Mitrovicës së Veriut
Municipality of Mitrovica North

LETËR E KONFIRMIMIT

Për pajtueshmërinë me të gjeturat e Auditorit të Përgjithshëm për vitin 2016 dhe për implementimin e rekomandimeve

Për: Zyrën Kombëtare të Auditimit

Vendi dhe data: Mitrovica e veriut

31.05.2017

I nderuar,

Përmes kësaj shkrese, konfirmoj se:

- kam pranuar draft raportin e Zyrës Kombëtare të Auditimit për Auditimin e Pasqyrave Financiare të Komunës së Mitrovicës Veriore, për vitin 2016 (në tekstin e mëtejme “Raporti”);
- pajtohem me të gjeturat dhe rekomandimet dhe nuk kam ndonjë koment për përmbajtjen e Raportit; si dhe
- brenda 30 ditëve nga pranimi i Raportit final, do t’ju dorëzoj një plan të veprimit për implementimin e rekomandimeve, i cili do të përfshijë afatet kohore dhe stafin përgjegjës për implementimin e tyre.

Kryetari i Komunës

Goran Rakić

21.

