



Financial Statements and Independent Auditors' Report

Municipality of Rahovec

31 December 2011

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Executive Summary

The Grant Thornton LLC on behalf of the Office of Auditor General has carried out an audit of the Annual Financial Statements of the Municipality of Rahovec for the year ended 31 December 2011.

Our audit was carried out in accordance with international auditing standards issued by International Organisation of Supreme Audit Institutions (“INTOSAI”) and included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements.

Below please find an extract taken from our audit opinion in page 7 of this document:

In our opinion, except for the possible effects of the matters described in the Basis for Qualified Opinion paragraphs 1 to 5, the financial statements present fairly, in all material respects, the receipts and payments of the Municipality for the year ended 31 December 2011 in accordance with the International Public Sector Accounting Standards – IPSAS “Financial Reporting Under the Cash Based Accounting”, with the Financial Rule No. 07/2011 on Annual Reporting of Budget Organizations.

The main messages to the Mayor, which led to qualification of our audit opinion, are:

1. Certain disclosures required by the IPSAS Financial Reporting Under The Cash Basis of Accounting and the Financial Rule No. 07/2011 On Annual Reporting of Budget Organizations were not made by the Municipality in preparing the financial statements as at and for the year ended 31 December 2011. In particular, the following was omitted or improperly disclosed in the financial statements
 - In section 14 There are no disclosures of the information on legislation, activities and other necessary information of the Municipality of Rahovec.
 - Section 12 Statement of Cash Receipts and payments is not properly completed and does not agree with Notes 8.
 - Section 15 Note 35 Balance of unspent own source revenue is not properly completed.
 - Payments from third parties, in section 12 Statement of Cash receipts and payments are not disclosed for the year ended 31 December 2011.
 - Section 21 and 27 not completed.
 - Receivables (used for revenue collecting organizations) are not appropriate completed.

Therefore we were unable to obtain reasonable assurance over the completeness and regulatory compliance of the financial information presented in the Municipality’s financial statements as

at and for the year ended 31 December 2011.

2. The comparative information for the years 2010 and 2009 is not appropriately presented:

- Section 12 Statement of Cash Receipts and payments is not properly completed for the year 2010 and does not agree with Notes 8.
- Section 17 Balance of unexpended own source revenue is not properly disclosed for the year 2011, 2010 and 2009

3. The Municipality does not maintain listings of payments from third parties. Due to the nature of records kept in the accounting and operational systems for payments from third parties, as well as the absence of alternative controls implemented by management, we were not able to perform sufficient and appropriate audit tests to verify the completeness of the payments from third parties recognized for the year ended 31 December 2011.

4. The property, plant and equipment owned by the Municipality are disclosed in financial statements. However, there are many deficiencies and uncertainties which affect the Municipality's financial reporting of property, plant and equipment as following:

- The balance of property, plant and equipment as disclosed in the Municipality's financial Statements as of 31 December 2011 in note 27 does not reconcile with its assets registry. Further, the Municipality has not registered property, plant and equipment in the Kosovo Financial Management Information System (referred to as "KFMIS").
- The Municipality has not appointed the Property valuation Committee and has not performed any evaluation of its assets as of 31 December 2011. They should have performed evaluation of all categories of assets: in use, damaged assets, property of non-transferred value, and evaluate requests for property alienation.

Due to the nature of the records and other deficiencies as described above, we were not able to satisfy ourselves with the disclosures, existence, completeness, accuracy and valuation of the Municipality's property, plant and equipment as of 31 December 2011.

5. As of 31 December 2011, the Municipality has not properly disclosed in its accounts receivables related the property tax, tax on business licence and other tax receivables which is required by the Financial Rule 07/2011. Additionally, the Municipality does not maintain complete debtors' records. Accordingly we were unable to satisfy ourselves as to account receivables balances as of 31 December 2011.

Internal Controls

Our audit has identified weaknesses in several areas of financial management. These weaknesses are described in more detail within the report. Our conclusion is that the Municipality's internal systems are not properly designed to eliminate evident weaknesses and are not implemented as they should be. In order to improve the functioning of the financial management system and internal controls, we recommend you to ensure:

- The Financial statements are prepared in compliance with the actual administrative instruction and IPSAS;
- A comprehensive list of its property, plant and equipment is maintained;
- An automated billing system for all type of taxes is maintained;
- Measures are taken to increase the collection of revenues from various taxes;
- Law No.03/L-241 amended 04/L-042 'Law on Public Procurement in Kosovo' is fully complied with

Management of the Municipality was given the possibility to comment on the findings presented in this report .Management has agreed to make all efforts to address our recommendation regarding internal control system, financial statements, property, plant and equipment, procurement, debts and handling of receivables.

1. Introduction

This audit relates to the annual financial statements of Municipality of Rahovec for the year ended 31 December 2011.

It is the responsibility of the Municipality to prepare financial statements in accordance with the Financial Rules 07/2011 and International Public Sector Accounting Standards (IPSAS) for “Financial Reporting under the Cash Basis of Accounting”.

Grant Thornton LLC, on behalf of the Office of the Auditor General, is responsible for carrying out an annual regularity audit on the Municipality financial statements as at and for the year ended 31 December 2011.

An audit is an attestation of financial accounting, involving examination and evaluation of Financial Statements and other financial records and provides assurance on:

- Whether the financial statements give a true and fair view of the accounts and financial affairs for the audit period;
- Whether the financial records, systems and transactions comply with applicable laws and regulations;
- The appropriateness of internal controls and internal audit functions; and
- Any other significant matters arising from or relating to the audit.

OAG carried out an interim audit of the Municipality. During that stage of the audit process they have addressed the Municipality’s handling of recommendations given earlier and the quality of financial management. Based on this they gave recommendations to the management. Their recommendations also included advice related to improvements for the financial statements to be in compliance with Financial Rule 07/2011 and International Public Sector Accounting Standards (IPSAS) for “Financial Reporting under the Cash Basis of Accounting”. This also included advice related to the preparation of the Annual Financial Statements. The Office of the Auditor General’s recommendations were submitted through an audit memorandum dated December 2011.

In order to fulfil our responsibilities for the audit of the Municipality, we have undertaken the following activities:

- Compared the Municipality’s Annual Financial Statements against the approved budget as at and for the year ended 31 December 2011;
- Determined whether the Municipality’s Annual Financial Statements were prepared in accordance with IPSAS “Financial Reporting under the Cash Basis of Accounting” and Financial Rule 07/2011;
- Established level a materiality, as a threshold for assisting in determining the type of opinion to render on the financial statements;
- Used a combination of judgement and random sampling to select transaction for testing;
- Undertook substantive testing of financial transactions; and
- Relied on a combination of interviews, analytical reviews, documents checking and physical verification to assess the validity and propriety of financial transactions;

In this report we summarise the audit findings and provide our opinion on the Annual Financial Statements as at and for the year ended 31 December 2011.

INTOSAI set out specific criteria that govern the type of opinion that should be rendered regarding our audit opinion for the Municipality's annual financial statements.

These are set out more fully in Appendix 1.

2. Audit Opinion

Independent Auditors' Report

To the Municipal Assembly
Rahovec Municipality, Kosovo

We have audited the accompanying financial statements of Municipality of Rahovec ("the Municipality"), which comprise the Statement of Cash Receipts and Payments for the year ended 31 December 2011, Budget Execution Report and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Public Sector Accounting Standards – IPSAS "Financial Reporting Under the Cash Based Accounting", with the Financial Rule No. 07/2011 on Annual Reporting of Budget Organizations, 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with international standards issued by the International Organisation of Supreme Audit Instructions (INTOSAI). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the 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 principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion

1. Certain disclosures required by the IPSAS Financial Reporting Under The Cash Basis of Accounting and the Financial Rule No. 07/2011 *On Annual Reporting Of Budget Organizations* were not made by the Municipality in preparing the financial statements as at and for the year ended 31 December 2011. In particular, the following was omitted or improperly disclosed in the financial statements:

- In section 14 There are no disclosures of the information on legislation, activities and other necessary information of the Municipality of Rahovec.
- Section 12 Statement of Cash Receipts and payments is not properly completed and does not agree with Notes 8.
- Section 15 Note 35 Balance of unspent own source revenue is not properly completed.
- Payments from third parties, in section 12 Statement of Cash receipts and payments are not disclosed for the year ended 31 December 2011.
- Section 21 and 27 not completed.
- Receivables (used for revenue collecting organizations) are not appropriate completed.

Therefore we were unable to obtain reasonable assurance over the completeness and regulatory compliance of the financial information presented in the Municipality's financial statements as at and for the year ended 31 December 2011.

2 The comparative information for the years 2010 and 2009 is not appropriately presented:

- Section 12 Statement of Cash Receipts and payments is not properly completed for the year 2010 and does not agree with Notes 8.
- Section 17 Balance of unexpended own source revenue is not properly disclosed for the year 2011, 2010 and 2009.

3 The Municipality does not maintain listings of payments from third parties. Due to the nature of records kept in the accounting and operational systems for payments from third parties, as well as the absence of alternative controls implemented by management, we were not able to perform sufficient and appropriate audit tests to verify the completeness of the payments from third parties recognized for the year ended 31 December 2011.

4 The property, plant and equipment owned by the Municipality are disclosed in financial

statements. However, there are many deficiencies and uncertainties which affect the Municipality's financial reporting of property, plant and equipment as following:

- The balance of property, plant and equipment as disclosed in the Municipality's financial Statements as of 31 December 2011 in note 27 does not reconcile with its assets registry. Further, the Municipality has not registered property, plant and equipment in the Kosovo Financial Management Information System (referred to as "KFMIS").
- The Municipality has not appointed the Property valuation Committee and has not performed any evaluation of its assets as of 31 December 2011. They should have performed evaluation of all categories of assets: in use, damaged assets, property of non-transferred value, and evaluate requests for property alienation.

Due to the nature of the records and other deficiencies as described above, we were not able to satisfy ourselves with the disclosures, existence, completeness, accuracy and valuation of the Municipality's property, plant and equipment as of 31 December 2011.

5. As of 31 December 2011, the Municipality has not properly disclosed in its financial statements, receivables related the property tax, tax on business licence and other tax receivables which is required by the Financial Rule 07/2011. Additionally, the Municipality does not maintain complete debtors' records. Accordingly we were unable to satisfy ourselves as to account receivables balances as of 31 December 2011.

Qualified Opinion

In our opinion, except for the possible effects of the matters described in the Basis for Qualified Opinion paragraphs 1 to 5, the financial statements present fairly, in all material respects, the receipts and payments of the Municipality for the year ended 31 December 2011 in accordance with the International Public Sector Accounting Standards – IPSAS "Financial Reporting Under the Cash Based Accounting", with the Financial Rule No. 07/2011 on Annual Reporting of Budget Organizations

Review of Compliance

In addition to our audit of the financial statements, a compliance review was planned and performed to express a conclusion with limited assurance as to whether, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities that govern them. The nature, timing and extent of the compliance work were limited compared to that designed to express an opinion with reasonable assurance on the financial statements.

Management's Responsibility for compliance

Management is responsible for the design and implementation of internal control to ensure that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities that govern them.

Auditor's responsibility

Our responsibility is to express a conclusion based on our review. Our work was conducted in accordance with the ISSAI 4200 *Compliance Audit Guidelines Related to Audit of Financial Statements*. Those principles require that we comply with ethical requirements and plan and perform the review so as to obtain limited assurance as to whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them.

A review is limited primarily to analytical procedures and to inquiries, and therefore provides less assurance than an audit. We have not performed an audit, and, accordingly, express our conclusion in the form of limited assurance, which is consistent with the more limited work we have performed under this compliance review.

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

Conclusion and compliance

Based on our review, because of the possible effect on the financial statements of the matters discussed in the Basis for Qualified Opinion paragraphs 1 to 5 and other matters noted in points 3 to 8 of this report, the activities, financial transactions and information reflected in the financial statements that have come to our notice during the review, are not in compliance with the authorities which govern them.

Other matters

We draw attention to the following:

1. The primary reliable source of information for the preparation of financial statements is Free Balance. However, since Free Balance is not being used to record payments from third parties, property, plant and equipment or receivables, it cannot be used to produce comprehensive financial statements.
2. Although the Mayor and Chief Financial Officer had signed the Declaration regarding presentation of the financial statements, the Municipality was not able to deliver a final draft of financial statements in Serbian language by the end of our audit.
3. The Municipality has not implemented a comprehensive and automated billing system and does not maintain separate sub ledgers or lists of all its debtors regarding various taxes. Instead only cash collections from revenue streams are recorded. Lack of accuracy and completeness will impact revenues that Municipality can earn and the ability to prepare a reliable and accurate budget, to report an accurate collection ratio, and monitor the collection of the own source revenues on a timely basis.
4. We identified some cases of noncompliance with Law No.03/L-241 and 04/L-042 "Law on Public Procurement in Kosovo" (amended). Such noncompliance related to required procedures which were not performed and documented by the Municipality.

5. Although the Municipality may be involved in several minor legal cases and it is probable that future cash outflows might be required in the near future, the Municipality did not design and implement any procedure for complete, accurate and reliable information for recording provisions and contingent liabilities.

Grant Thornton LLC

Prishtina, Kosovo
29 June 2012

3 Status of Prior Years Recommendations

Our management letter, as at and for the year ended 31 December 2010, identified five main recommendations. One of these recommendations related to establishment and function of Audit committee has been resolved, while the other four recommendations still remain to be completely addressed:

- The financial statements should be prepared in compliance with the actual administrative instruction and IPSAS.
- The Municipality does not maintain separate register for its property, plant and equipment, neither register in Financial Management Information System in Kosovo (FMISK),
- An automated billing system for all types of taxes should be put in place, reconciliations of revenues between the own source revenue officer and operational departments should be regularly performed, and measures should be taken to increase the collection of revenues from various taxes;
- Compliance with financial rules 02 – Expenditure of public money.
- Compliance with Law on Public Procurement in Kosovo should be ensured ;and

Failure to fully address our given recommendations, has led us to have similar findings as in 2010.

4 Financial outcome compared to approved budget

The analysis of Actual Outcome in the Financial Statements compared the Approved Budget indicates:

Table 1: Overview of budget and actual spending

Description	Initial Budget	Final Budget	Receipts/ Expenditures 2011	Receipts/ Expenditures 2010
I. Total of receipts and transfer of donations	9,513,658	10,469,504	9,965,837	7,722,164
Government Grant-Budget	8,798,158	8,884,159	8,748,020	7,068,874
Own source revenue	715,500	1,120,501	949,992	653,290
Domestic Donations	-	2,412	2,380	-
External Donations	-	462,432	265,445	-
II. Total of Expenditures	9,513,658	10,469,504	9,965,837	7,722,164
Wages and salaries	5,130,263	5,262,956	5,151,331	3,995,808
Goods and services	674,947	917,533	876,762	595,938
Utilities	268,712	268,712	268,618	268,109
Subsidies and Transfers	123,764	124,085	123,759	119,929
Capital Investments	3,315,972	3,896,219	3,545,366	2,742,380
Reserves	-	-	-	-
Difference I-II	-	-	-	-

According to the data presented in the table above, we may see that the final budget of Municipality of Rahovec was Euro 10,469,504 during 2011. The total expenditures for the year 2011 were in the amount of Euro 9,965,837, or approximately 95% of the final budget. The unspent budget by the end of the year 2011 was in the amount Euro 503,667 or approximately 5% of the final budget.

The final budget was higher than the initial budget in the amount of Euro 955,846 due to the carried forward of own source revenue from 2010 in the amount Euro 405,001 and donation in the amount Euro 464,844 while the rest of the difference from the General Fund refers to the budget increase for salaries decided on government level.

Conclusion

Based on above, the Municipality of Rahovec has spent the total budget for 2011 in accordance with the projections and ceilings set by the Assembly of Kosova.

5 Financial Statements-Compliance with reporting framework and the quality of information

Requirements in LPFMA No. 03/L-048 and Financial Rule 07/2011.

- Financial Statements have been signed by the Chief Administrative Officer and Chief Financial Officer of the Municipality of Rahovec;
- Financial Statements are signed within the required time frame on 31/01/2012 and Submitted to MF and also corrected and resubmitted on 29/02/2012 ;
- The financial Statements were submitted only in the Albanian language; and
- The Municipality has prepared and submitted regular quarterly reports to MF during 2011.

1. Recommendations

We recommend the Mayor ensures that the preparation of the Municipality's financial statements should include procedures and tools that are designed to ensure that information required is recorded, processed, summarized and appropriately reported in the financial statements.

The Municipality should also prepare financial statements in Serbian language.

6 Financial Management

6.1 Revenues (including own source revenues)

Findings

- The Municipality's management was unable to present detailed separate sub ledgers of its debtors regarding taxes. Without sufficient detailed and accurate records of debtors, the Municipality is unable to prepare reliable and accurate budget as well as collect its own source revenues on a timely basis. As a result, it is not possible to perform a proper reconciliation or analysis by debtor.
- During our audit we noted that there is no regular monthly reconciliation between departments which collect own source revenues such as: Property Tax Department, Rent income Department, Geodesy Department, Urbanism Department etc., although there is own source revenue officer from Finance and Budget Department, who is responsible to reconcile and clarify any difference which arise between Municipality records and Free Balance.
- During our audit we identified that transactions are not recorded in Free Balance when occurred i.e. when paid. Instead, transactions are grouped (for more than one day) and as such, registered in Free Balance system.
- During our audit we identified that the own source revenues are not recoded on their intended accounts as per the chart of accounts.
- Collection of revenue from participation from Health department is not transferred to bank on daily basis.

Conclusion

Lack of accuracy and completeness of accounts receivables ledgers will impact the revenues that the Municipality can earn. Without sufficient, detailed, and accurate records of debtors and reports on collections, the Municipality is unable to prepare a reliable and accurate budget, to neither report an accurate collection ratio, nor follow up the collection of the own source revenues on a timely basis. Furthermore, the low collection of revenues will impact the investing capacity of the Municipality.

Improper and insufficient controls related to revenues and the related software and billing system increase the risk of manipulation of figures and misuse of information. Such a system could lead to incomplete billing and incomplete revenues.

2. Recommendation

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

- Implement a billing system that includes updated details about the payers, their current address, history and collection rating. Such information should be accessible only to a limited number of persons and with the authorization of the management.

- Enter and centrally control the approved tariffs and tax rates in the system in order to calculate and generate the bills automatically. The generation of bills should also be authorized and reviewed.
- Automatically inter-connect the billing system with the accounting software so that the information is automatically processed into the general ledger.
- Automatically link the operational and billing units and perform regular reconciliations between them, in cases where the billing is directly related to services supplied by the operational units. This is especially important where a high volume of transactions is executed.
- Perform regular reconciliations between the departments and the income officer and any reconciling differences should be promptly followed up and cleared in a timely manner. The revenues should be recorded as per chart of the accounts.
- We advise the Municipality to ensure that the cash collected from participation to be deposited in the bank within the required timeframe.

6.2 Expenditures

6.2.1 Remunerations (Wages and Salaries)

Findings

During our audit we identified that there is a difference in category wages and salaries with the payroll in amount of Euro 30,560. The Municipality has disbursed this amount from wages and salaries to the implementing partner AnaDrinia for the project financed by ECLO relating to the construction of vegetables storages.

Furthermore while reviewing the employee's files we have found that some of the documents on the files were missing.

Furthermore from the tested salary lists we have identified that there were instances on unsigned lists. An example as such is that during the month of January, in the department of primary education (93300), the salary lists have not been signed for the following schools: Mihal Grameno, Vuk Karadzic, Bajram Curri, S.Markovic V.Hoca and Isa Boletini.

In addition there have been several cases in which the recruitment procedures applied have not been in accordance with the law on Civil Service Nr.03/L-149 Article 11.1 the recruitment through public publications, and there have been several instances of incomplete files.

3. Recommendations

We recommend the Mayor ensures to sign every month each employee list of salaries. Further, recruitment and personnel files are properly maintained with all required documents as per law in force.

6.2.2 Procurement

Findings

During our inspection of source documents for the sample tested by us, we noted several non-compliances with procedures as required by Public Procurement Law. These non-compliances are described below:

In the Construction of road: Zoqisht-Reti second phase with contract no 62311069521, and with contract amount of 474,824 Euro, there were delays in the performance of the agreement and Municipality did not apply penalties as it is foreseen in contract agreement in case when the contract is not executed in time. In addition the guarantee related to execution of works was not valid throughout the entire period of the work execution. Furthermore, no diary of works performed was kept by the supervisor and there was no technical acceptance of the works performed.

In the Construction of river side: Rimmik, with contract no 62311070521, and with contract amount of 344,142 Euro, there was no insurance execution policy for the works. There were delays in the performance of the agreement and Municipality did not apply penalties as it is foreseen in contract agreement in case when the contract is not executed in time. Furthermore, no diary of works performed was kept by the supervisor and there was no technical acceptance of the works performed.

In the Construction of road: Zoqisht-Reti-Reti e Ulet (asphalting) with contract no 623 11 014 521, and with contract amount of 167,002 Euro, the commitment of funds is not signed by the authorization officer. The head of evaluation committee was at the same time appointed the supervisor of the works. The supervisor of works didn't prepare reports related to the completion of works. The Municipality has not received the insurance guaranty (for one year) for works performed as it is specified in the contract. The EO's were not informed as required by the article 42 point 4 of PPL. In addition, the guarantee related to execution of works was not valid throughout the entire period of the work execution. There were delays in the performance of the agreement and Municipality did not apply penalties as it is foreseen in contract agreement in case when the contract is not executed in time. Furthermore, no diary of works performed was kept by the supervisor and there was no technical acceptance of the works performed. There was no technical acceptance report from the commission.

In the Construction of Primary Health Building in Ratkoc village with contract no 623 11 029 521, and with contract amount of 126,419 Euro, the head of evaluation committee was at the same time appointed the supervisor of the works. The supervisor of works didn't prepare reports related to the completion of works. In addition the guarantee related to execution of works was not valid throughout the entire period of the work execution. There was no commission for technical acceptance of the work. There were delays in the performance of the agreement and Municipality did not foresee cases when the contract is not executed in time and the penalties to be charged.

During our testing of procurement files we have noted that there are several procurement cases when the contract was awarded to the successful bidder based on the criteria "Lowest price" and then there were annexes to these contracts signed with the same suppliers for additional amounts. Below are presented three projects identified with annex agreements.

- Construction of road: Zoqisht-Reti-Reti e Ulet (asphalting)
- Construction of field road in Municipality of Rahovec
- Construction of roads (city-village) in Municipality of Rahovec

Furthermore during the procurement procedures, the Municipality did not use the standard form of contracts that are part of the bidding documents and that encompasses all necessary general and special terms of contract.

In addition we identified that the Municipality has made payments to Association of Doctors in Kosovo (AMFK) for amount of Euro 4,650 from the category of goods and services without procurement procedures.

4. Recommendations

We recommend the Mayor to ensure that;

The Municipality establish sufficient adequate control procedures for effective monitoring over the compliance with the applicable laws and regulations.

We recommend the Mayor to ensure the Municipality to apply properly the contractual terms and conditions and to apply the penalties when the contractor will not finish the project on time. This applies especially when the request to extend the deadline before it expires as determined in the contract, was not submitted.

6.2.3 Subsidies and transfers

Findings

The Municipality does not have written policy on subventions, that will contain criteria and the procedures for subvention allowance, so the subventions are allowed only based on the Municipality Mayor decision.

Conclusion

Lack of timely communication and approvals from authorities or incomplete documentation may lead to non-compliance with Laws or Contract requirements and to significant losses.

5.Recommendation

We recommend the Mayor to ensure that;

The Municipality establish sufficient adequate control procedures for effective monitoring over the compliance with the applicable laws and regulations.

6.3 Assets

6.3.1 Handling of capital and non-capital assets

We have reviewed the compliance of the process of registration, keeping records, and management of non-financial assets with the requirements of the Administrative Instruction no.21/2009 on the Management and registration of government assets. We noted several non-compliances with Administrative instruction

Finding

The Municipality does not have documented procedures and does not maintain separate register for its property, plant and equipment and accounting data from Kosovo Financial Management Information System (KFMIS). Moreover, the Municipality has not finalized annual count and verification of physical existence of the assets as of 31 December 2011 which is not in compliance with the requirements of the Administrative Instructions No. 21/2009 on Management of Government Property. Inventory committee has not prepared the Inventory report related the inventorying of PPE as below:

- They did not prepare the separate reports related the assets with non – transferred value, on damaged and disposed assets.
- They did not perform the reconciliation between the physical check of PPE with accounting records.

Conclusion

The Municipality does not have complete and accurate records on assets. This weakness in the internal controls over these assets may lead to assets being misappropriated and not being identified as such on a timely basis. Additionally, management may waste time and effort to identify the details and the carrying value of the assets, during any related decision making processes.

6. Recommendation

We recommend the Mayor to ensure that the Municipality develops and communicates a set of policies and procedures regarding property, plant and equipment. Management should perform physical count and verification of the existence of all tangible assets and to maintain and record the property, plant and equipment register on annual basis. Missing items should be investigated and if necessary written-off.

In addition and as a minimum, the aforementioned register should contain the following information for each fixed asset:

- Acquisition date
- Location
- Number assigned by the Municipality (tag number)
- Serial number
- Description and function
- Cost
- Details of depreciation, including methods of computation
- Anticipated useful life
- Maintenance cost subsequent to the date of acquisition
- Date of disposal
- Financing source
- Expense voucher reference number.

Furthermore, and for the purpose of providing adequate safeguarding of its assets, that should perform regular and at least annual, physical count of all property, plant and equipment items. Related accounting records have to be reconciled with the results of such physical counts.

6.4 Handling of debts

The liabilities not paid to suppliers at the end of 2011 were Euro 277,936. These liabilities are carried forward to be paid in 2012.

Findings

During our audit, we identified several cases where payments were done more than 30 days after the invoice receipt date which is not in accordance with provisions of Treasury Guidelines and financial rule 02-Expenditure of public money.

Conclusion

Considering the above, various legal claims could be asserted in the future and hence there is a risk of additional penalties to be imposed against the Municipality.

7. Recommendations

We recommend the Municipality's Mayor to follow all provisions of Treasury Guidelines and financial rule 02 – Expenditure of public money issued from the Government of Kosovo and to settle the liabilities within 30 days.

6.5 Current reporting and timeliness in the overall budget process

The Municipality has fulfilled its external reporting obligations. The fulfilled obligations are:

- Budget request;
- Quarterly reports including timely nine month financial statements;
- Timely draft procurement plan; and
- Reports on debts submitted to the MF.

Findings

During our audit, we identified that Municipality has not prepared regularly and submitted regular monthly debt reports to MF during 2011.

8. Recommendations

We recommend the Mayor ensures that the Municipality considers the following:

- To establish control and takes appropriate responsibility to fulfil the requirements for external debt reporting according financial rule 04/2011.

7 Management Control

7.1 Internal Control Systems

We identified shortcomings in the annual financial statements, revenues management, procurement procedures and asset management during our audit as mentioned in this report.

Conclusions

The current implementation of internal controls is at an insufficient level.

9. Recommendations

We recommend the Municipality to ensure that:

- The overall financial administrative and managerial controls are strengthened; and
- Immediate actions are taken securing a better handling of shortcomings in the implementation of internal control.

7.2 Internal Audit system

The Municipality has established Audit Committee and an Internal Audit function which is also required by the current forcible regulation law no 03/L-128 and administrative instruction 11/2010 on the establishment and function of internal audit committee. The Municipality undertake the action by responsible to address this issue which was reported in our prior year audit

Internal Audit Unit operating with one director and two auditors. This unit has prepared a strategic plan and an annual audit plan which are also approved by the Audit Committee.

8 Overall conclusion on the Management of Municipality

General conclusion

Our overall conclusion is that the Municipality Management has not managed yet to establish fully efficient internal control systems. Apart from some improvements in the field of financial and assets reporting, weaknesses were noted in several areas of Financial Management.

The Municipality Management should raise the managers' and staff's awareness on the need of controls. The PIFC framework should serve as a platform for establishing control. The need to increase transparency and accountability at all levels of the organization is one of the basic requirements for building a good governance structure.

The Municipality Management should permanently provide reliable financial reporting and assess the risk of material errors and mistakes in the financial statements. Risk should also be assessed when it comes to assets and revenues management when complete registers and records are missing.

10.Recommendation

We recommend the Municipality to ensure that:

- Clear policies on all Municipality's important activities are issued and that an action plan specifying immediate actions to be taken is drafted.
- To implement our recommendations on points 3 to 7.

Annex I

Different forms of Audit Opinion Based on ISSAI 400

(Extract from ISSAI 400)

An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse (paragraph 14) or a disclaimer (paragraph 15) of opinion.

An **unqualified opinion** is given when the auditor is satisfied in all material respects that:

- (a) The financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;
- (b) The statements comply with statutory requirements and relevant regulations;
- (c) The view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and
- (d) There is adequate disclosure of all material matters relevant to the financial statements.

Emphasis of Matter. In certain circumstances the auditor may consider that the reader will not obtain a proper understanding of the financial statements unless attention is drawn to unusual or important matters. As a general principle the auditor issuing an unqualified opinion does not make reference to specific aspects of the financial statements in the opinion in case this should be misconstrued as being a qualification. In order to avoid giving that impression, references which are meant as “emphasis of matter” are contained in a separate paragraph from the opinion. However, the auditor should not make use of an emphasis of matter to rectify a lack of appropriate disclosure in the financial statements, nor as an alternative to, or a substitute for, qualifying the opinion.

An auditor may **not be able to express an unqualified opinion when** any of the following circumstances exist and, in the auditor's judgment, their effect is or may be material to the financial statements:

- (a) There has been limitation on the scope of the audit;
- (b) The auditor considers that the statements are incomplete or misleading or there is an unjustified departure from acceptable accounting standards; or
- (c) There is uncertainty affecting the financial statements.

Qualified Opinion. Where the auditor disagrees with or is uncertain about one or more particular items in the financial statements which are material but not fundamental to an understanding of the statements, a qualified opinion should be given. The wording of the opinion normally indicates a satisfactory outcome to the audit subject to a clear and concise statement of the matters of disagreement or uncertainty giving rise to the qualified opinion.

It helps the users of the statements if the financial effect of the uncertainty or disagreement is quantified by the auditor although this is not always practicable or relevant.

Adverse Opinion. Where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position presented to the extent that an opinion which is qualified in certain respects would not be adequate, an adverse opinion is given. The wording of such an opinion makes clear that the financial statements are not fairly stated, specifying clearly and concisely all the matters of disagreement. Again, it is helpful if the financial effect on the financial statements is quantified where relevant and practicable.

Disclaimer of Opinion. Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to an uncertainty or scope restriction which is so fundamental that an opinion which is qualified in certain respects would not be adequate, a disclaimer is given. The wording of such a disclaimer makes clear that an opinion cannot be given, specifying clearly and concisely all matters of uncertainty.

It is customary for SAIs to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.

Annex II. Prior year Recommendations

Audit Component	Recommendation given	Recommendation fully implemented	Partly addressed	Not addressed
1 Financial statements	The preparation of the Municipality's financial statements should include procedures and tools that are designed to ensure that information required is recorded, processed, summarized and appropriately reported in the financial statements.	Partly	Outstanding invoices (liabilities/contingencies) and outstanding invoices (receivables) are presented in financial statements .The municipality has taken action to implement recommendations related assets but not fully implemented.	
2.Property plant and equipment	We recommend Municipality of Rahovec to develop and communicate a set of policies and procedures regarding property, plant and equipment. Management should perform physical count and verification of the existence of all tangible assets and to maintain and record the property, plant and equipment register on annual basis. Missing items should be investigated and if necessary written-off. In addition and as a minimum, the aforementioned register should contain the following information for each fixed asset: - Acquisition date - Location	Not Implemented		.

	<ul style="list-style-type: none"> - Number assigned by the Municipality (tag number) - Serial number - Description and function - Cost - Details of depreciation, including methods of computation for both tax and financial reporting purposes - Anticipated useful life - Maintenance cost subsequent to the date of acquisition - Date of disposal - Financing source - Expense voucher reference number. <p>Furthermore, and for the purpose of providing adequate safeguarding of its assets, that should perform regular and at least annual, physical count of all property, plant and equipment items. Related accounting records have to be reconciled with the results of such physical counts.</p>			
3 Revenue	<p>We recommend that the Municipality takes steps to improve the billing and accounting systems in order to ensure safe, efficient and effective controls on the billing and the revenue.</p> <p>Improvement of the procedures related to such systems would enable the management to monitor and manage significant risks, and to ensure that decisions related to budgeting, planning</p>	Not Implemented		

	<p>and collection of revenues are properly carried out. We recommend that the Municipality:</p> <ul style="list-style-type: none"> -Implement a billing system that includes updated details about the payers, their current address, history and collection rating. Such information should be accessible only to a limited number of persons and with the authorization of the management. -Enter and centrally control the approved tariffs and tax rates in the system in order to calculate and generate the bills automatically. The generation of bills should also be authorized and reviewed. -Automatically inter-connect the billing system with the accounting software so that the information is automatically processed into the general ledger. -Perform regular reconciliations between Free Balance and internal records of each department on a regular basis for all types of revenues. Any reconciling differences should be promptly followed up and cleared in a timely manner. -Automatically link the operational and billing units and perform regular reconciliations between them, in cases where the billing is directly related to services supplied by the operational units. This is especially important where a high 			
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	volume of transactions is executed.			
4 Expenditures	Lack of supporting documents and payments made.	Partly		
4.1 Remunerations (wages and salaries)	Some of files are not completed with all necessary documents.	Not implemented		
4.2 Subventions and Transfers	Lack of supporting documents and payments made	Note Implemented		
5 Procurement	The Municipality should establish sufficient adequate control procedures for effective monitoring over the compliance with the applicable laws and regulations, especially the requirements of the Law on Public Procurement (PPL) and other legal framework on force..	Not Implemented		
7.2 Internal Audit system	The Municipality has not established Audit Committee. No action was undertaken by responsible to address this issue which was reported in our prior year audit.	Implemented	The Municipality took action to establish Audit Committee.	

Annex III. Municipality's comments and Auditor response

Recommendations	Agree	Partly agree	Not Agree	Municipality Comments	Response of the Auditor
1. Financial Statements				<p>We consider that statement of Cash Receipts and Payments with cash is completed and in accordance with section 12 of the financial rules 07/2011.</p> <p>We consider that section 15 of the disclosure 35 are presented in the financial statements which relates to the unpaid liabilities and contingent liabilities. As an annex to the comments we attach the list of liabilities for goods and services and capital investments.</p> <p>During 2001, the Municipality of Rahovec did not have any payments from third parties and as such are not presented in the financial statements.</p> <p>Section 21, where it is stated that the budget organizations should respect the deadlines for delivering the financial, the municipality has respected such deadline and such financial statements can be found in the Ministry of Finance in the Treasury department, whereas the section 27 does not exist in the financial rule no. 07/2011.</p>	Auditor findings remain

Recommendations	Agree	Partly agree	Not Agree	Municipality Comments	Response of the Auditor
2. Revenue				<p>We consider that the receivables are complete in a appropriate manner, except the receivables from the Property tax, due to the reason that the existing software which is installed in the all municipalities of Kosova do not allow such analytical data to be recorded there, but the datas it generates in total. As an annex to this comment we have attached the list of receivables from the business taxes and the list of receivables from rent.</p> <p>It is impossible that the transactions to be recorded in the SIMFK in the day that the transactions occur, but such transactions are recorded in the following day which are done by the official person for revenues.</p> <p>Own source revenues are recorded based on the economic codes, based on the unified standards with referent numbers for collecting the public revenues from the Ministry of Finance. As an annex to this we have attached the form for registering of own source revenues.</p>	Auditor findings remain
3. Remunerations (Salaries and Wages)				<p>The value of grant earned from the European Commission is amount of EUR 294,000. This amount of budget is divided based on the following categories for goods and services, capital investment and for salaries and wages. The amount of EUR 30,560 it is dedicated to the position for Wages and Salaries. This amount the Municipality has made only a transfer – expense in the account of implementing partner “Anadrini” (and not Agrodrini), in the name of the project Collecting point for trees and others in the village Xerxe, and not from the list of wages and salaries of the Municipalities. As an annex to this we have attached the CPO generated from the Treasury.</p> <p>In January 2011 the payroll lists are transferred wrongly with</p>	Auditor findings remain

Recommendations	Agree	Partly agree	Not Agree	Municipality Comments	Response of the Auditor
				<p>50% increase from the Ministry of Finance and is requested that all employees of Educational department signed such lists. But at the end of the month of January, a new payroll lists arrived for the same month without the increase. The majority of the employees signed the new lists, a small number of employees refused to sign the new lists for the same month. Exceptions are the lists of Serbian employees, which never signs the payroll lists, even thus many time we have submitted to them for signature</p> <p>The findings of the Auditor General is totally not true, because there is not a single employee which is hired during 2011 without proper public announcement and the recruitment of the employee is done in accordance with the Law for civil servants nr. 03/L-149 and regulation of MAP nr. 02/2010 for the recruitment procedures. In addition, all the employee files are completed with the required documents as specified in the regulation of MAP nr. 03/2011 for files and central register of civil employees. We also mention a fact that the employee personal file differs from the job announcement file and those two files have different treatment and are archived separately. We consider that this announcement of Auditor General is general and not true</p>	
4. Procurement				<p>We inform you that there are no delays related to this contract but in opposite the work is being completed in advance of the deadline, based on the dynamic plan from the O.E. We should also mention that the works are executed based on the dynamic plan and such works are monitored from the Supervisory commission, who keeps evidence for each phase and any delays, especially during the winter where there are problems due to weather or any property contest. You have</p>	Auditor findings remain

Recommendations	Agree	Partly agree	Not Agree	Municipality Comments	Response of the Auditor
				<p>mentioned that the insurance for execution of works is not valid during the execution of works. We confirm you that the insurance execution of works is six months in length, and has a validity twice more that the dynamic plan which is for execution of works (90 days).</p> <p>We inform you that we accept that the insurance for execution of works is not found in the tender file physically there, but it was in the file of the Bidder which has a validity until 01.01.2013.</p> <p>Also for this tender there are no delays in execution of works, due to the reason that the works are still on-going based on the dynamic plan and still there is no technical acceptance of the project as the project is not completed still.</p> <p>We inform you that, the Economic Operator has offered the insurance for execution of works based on the dynamic plan that the works will be completed on time, but due to weather changes and other property possession issues with the community are created delays which does not have to do with the contractor. The supervisory commission has not done a report for completion of works, due to the reason that after the analysis of the samples for thickness of Asphalt it was noted that thickness of asphalt is thinner than requested.</p> <p>It is requested that from the contractor (economic operator) in a short time to complete the road as per request and to do the asphaltting of road again for those requested parts. The Municipality of Rahovec had deducted 10% from the contract value. The report of Supervisory commission now exists in the tender file will all the samples and specified notices.</p> <p>We inform you that during the period of auditing, the works were</p>	

Recommendations	Agree	Partly agree	Not Agree	Municipality Comments	Response of the Auditor
				<p>on-going process and un finished, and the supervisor has not done the final report. And as a result there was no commission for technical acceptance of works due to the project was not completed.</p> <p>The procurement office still does not know whether was any delay in days or in execution of works until the final report is not arrived by the supervisory commission which has monitored the works against the dynamic plan.</p> <p>The validity of the insurance for execution of works is a practise which is applicable in all Kosova based on the dynamic plan for completion of works, because in rare cases happens that the delays to be for the fault of economic operator (contractor) The delays are happening mainly due to the reason above.</p>	
5. Subventions and Transfers				No comment	
6. Property plant and equipment				The municipality of Rahovec during 2011 has established the commission for registering and valuing the fixed asset in the municipality, but was not able to complete such process during the deadline to enter the datas in the system of free balance, which datas we have provided to the external auditors.	
7. Handling of debts				No comment	
8. Current reporting and timeliness in the overall budget process				No comment	

Recommendations	Agree	Partly agree	Not Agree	Municipality Comments	Response of the Auditor
9. Internal Control Systems				No comment	
10. Overall conclusion on the Management of Municipality				No comment	

