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**AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE MUNICIPALITY OF
PEJA FOR THE YEAR ENDED 31 DECEMBER 2010**

Prishtina, June 2011

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List of Abbreviations

AC	Audit Committee
AFS	Annual Financial Statements
AG	Auditor General
AI	Administrative Instruction
CAO	Chief Administrative Officer
EO	Economic Operator
IAS	International Accounting Standards
IAU	Internal Audit Unit
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
IRD	International Relief and Development
ISSAI	International Standards of Supreme Audit Institutions
KFMIS	Kosovo Financial Management Information System
LIA	Law on Internal Audit
LPFMA	Law no. 03/L-48 on Public Finance Management and Accountabilities
LPP	Law no. 02/L-99 on Public Procurement as amended and supplemented on 8 th of February 2007. Including the new Law no 03/L-241 enforced as of 1 st December 2010.
OAG	Office of the Auditor General

Executive Summary

The Office of the Auditor General (OAG) has carried out an audit of the Annual Financial Statements (AFS) of Peja Municipality for the year that ended 31 December 2010.

Our audit was carried out in accordance with international auditing standards issued by INTOSAI and included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements.

In forming our opinion we have evaluated the overall adequacy of the presentation of information in the financial statements.

In our opinion the financial statements *in all material aspects present a true and fair view.*

We would like to draw your attention to the fact that the disclosed information on fixed assets and accounts receivables is incomplete and inaccurate. The incomplete disclosure of fixed assets and accounts receivables does not affect our opinion on the financial statements compiled in accordance with the IPSAS for Cash based accounting. (ISSAI 400: *Unqualified Opinion with an Emphasis of Matter*)

Our audit has identified weaknesses in some financial management areas. These weaknesses are described in details within this report. They should be addressed by the Management in order to improve the performance of the organization.

On AFS of 2009 were given five recommendations. None of these recommendations were addressed.

Our key recommendation to the Mayor is to ensure that clear instructions and procedures are developed, which assist in addressing the weaknesses identified in this report.

We recommend you to particularly ensure that:

- All recommendations given for 2009 are addressed;
- Annual Financial Statements are prepared fully in accordance with the AI;
- All own source revenues are regularly reconciled;
- Procurement activities are carried out in accordance with the LPP;
- All accounts receivables are disclosed in accordance with AI no.16/2010;
- Full and accurate registers are maintained of outstanding liabilities by the Department of Finance; and
- Assets Registers of the Municipality are complete.

The Management of the Municipality has been given the possibility to give comments on the draft of this report.

The Management of the Municipality has acknowledged our findings and conclusions presented in the audit report on the AFS for the year 2010.

They are committed to make every effort to address all recommendations given.

I. Introduction

This audit relates to the AFS of the Municipality of Peja for the year that ended on 31 December 2010.

It is the responsibility of the Municipality's Management to prepare AFS in accordance with the Administrative Instruction 16/2010 and International Public Sector Accounting Standards (IPSAS) for "Financial Reporting under the Cash Basis of Accounting.

The Office of the Auditor General is responsible for carrying out annual regularity audits in the Peja Municipality.

A Regularity Audit is defined as an attestation of financial accounting, including the examination and evaluation of Financial Statements and other financial records and expression of opinions on:

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

We have carried out an interim audit of Peja Municipality. During that stage of the audit process, we have addressed the handling of recommendations given earlier as well as the quality of financial management. We have also advised the management to address the issues in the AFS through the audit memorandum submitted in December 2010.

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

- We have reviewed the AFS of the Municipality against the approved budget for 2010;
- We have determined whether they were prepared in accordance with IPSAS "Financial Reporting under the Cash Basis of Accounting";
- We have established a materiality level of revenues and expenditures, as a threshold for assisting in determining the type of opinion to render on the financial statements;

- We have used a combination of judgment and random sampling to select transactions for testing;
- We have undertaken extensive substantive testing of financial transactions;
- We relied on a combination of interviews, analytical reviews, document reviews, and physical verification to assess the validity and propriety of financial transactions; and
- We have assessed the quality of work in the Municipality's Internal Audit Unit.

In this report we summarise this year's audit and present a formal opinion on the AFS of Peja Municipality for year 2010.

In regard to our audit opinion on the Municipality's AFS, the international audit standards set out specific criteria that govern the type of opinion that can be rendered.

These are set out more fully in Appendix 2.

II. Audit Opinion

In our opinion the financial statements *in all material aspects present a true and fair view.*

We would like to draw your attention to the fact that the disclosed information on fixed assets and accounts receivables is incomplete and inaccurate. The incomplete disclosure of fixed assets and accounts receivables does not affect our opinion on the financial statements compiled in accordance with the IPSAS for Cash based accounting.

(ISSAI 400: *Unqualified Opinion with an Emphasis of Matter*)

III. Status of Prior years recommendations

The audit report on the AFS for the year 2009 resulted with five key recommendations. Out of which, none of the recommendations were addressed. These recommendations are related to:

- Preparation of financial statements based on all relevant information;
- Complete registration of fixed assets;
- Improvement of the accounting system, by applying an automatic invoicing system;
- Registration of all outstanding liabilities; and
- Strengthening of the Internal Audit as a tool to prevent errors.

Failure to fully address our recommendations has caused the occurrence of the same problems as in the previous years. We express our concern regarding the recommendations that were not implemented.

IV. Financial Outcome versus approved budget

The analysis of the Outcome in the Financial Statements versus the Approved Budget shows:

Table 1: Overview of budgets and spending in Euros (€)

Description	Initial budget	Reviewed budget	Final budget	2010 Outcome	2009 Outcome
Government Grant - Budget	11,901,808	12,244,700	12,499,812	12,479,354	10,887,000
Own Source Revenues	2,391,751	2,391,751 ¹	3,297,324 ²	2,484,255	3,112,000
Domestic Donations			38,445	15,228	
External Donations			942,189	610,005	580,000
I. Total of revenues and transfer of donations	14,293,559	14,636,451	16,777,770	15,588,842	14,579,000
Wages and Salaries	7,558,885	7,981,092	8,297,236	8,264,596	7,273,000
Goods and Services	1,076,027	1,101,021	1,463,350	1,327,424	1,112,000
Utilities	495,412	496,810	506,809	505,753	493,000
Subsidies and Transfers	226,948	287,148	290,022	286,867	245,000
Capital Investments	4,936,287	4,770,380	6,220,353	5,204,202	5,456,000
II. Total of Expenditures	14,293,559	14,636,451	16,777,770	15,588,842	14,579,000

According to the data presented in the table above, we may see that the final budget of Peja Municipality was €16,777,770 in 2010. The total of expenditures for the year 2010 was in the amount of €15,588,842, or around 93% of the final budget. The unspent budget by the end of the year 2010 was in the amount of €1,188,928 or 7%.

The final budget was higher than the reviewed budget because during 2010 the Municipality has benefited from domestic donations in the amount of €38,445, as well as from external donations in the amount of €42,189.

Meanwhile, the final budget from the Government Grant was higher than the Reviewed Budget by €255,112 because MEF allocated €15,112 for payment of meal allowances and €40,000 for capital investments at the end of the year.

¹ Planned revenues

² This amount includes the own source revenues carried forward from 2009 in the amount of €765,624 and the collected revenues for year 2010 in the amount of €2,531,700€

Out of the revenues from domestic donations, €15,228 were mainly spent on capital investments. Out of the revenues from external donations, €493,790 were spent on capital investments and €116,215 on Goods and Services.

Conclusion

The Municipality's Management has shown a quite effective budget performance. The data presented above show an effective use of budget.

V. Financial Statements

V.1 Compliance regarding the external reporting

Based on Regulations of the LPFMA no. 03/L-48 and AI 16/2010, we have identified the following:

- The Municipality has prepared the AFS fully in compliance with the AI no. 16/2010 with exception to the disclosure of receivables and assets;
- The Municipality's AFS have been prepared in accordance with IPSAS "Financial Reporting on Cash Based Accounting";
- They have been signed by the Chief Administrative Officer and Chief Financial Officer;
- The AFS have been signed and submitted to the MEF within the time frame on 31/01/2010;
- The AFS were received only in Albanian; and
- The Municipality prepared and submitted regular quarterly reports to the Minister of MEF during 2010.

Conclusion

AFS were prepared in accordance with AI with the exception of disclosure of accounts receivable, assets and preparation only in one language.

V.2 Information Quality

The AFS contained these shortcomings:

- Note 27 - non-financial assets – included the amount of €3,771,000, which is not accurate due to the lack of an overall registration of fixed assets. According the affirmations by the Assets Officer, this amount does not present the factual situation due to failure to maintain a complete registration of fixed assets; and

- No amount on the receivables was registered in Note 28.

Conclusion

From reviewing the AFS, we conclude that the Municipality failed to disclose all the information required under the AI. Lack of such disclosures results in unfair and inaccurate presentation of the financial and non-financial information in the AFS.

Recommendation 1

We recommend the Mayor to ensure that:

- When preparing the Financial Statements, all the requirements stemming from the AI are adhered to so that they present a fair view on the financial situation of the Municipality; and
- Financial Statements for the nine-month period of 2011 are prepared.

VI. Budget Execution

VI.1 Revenues (including the own source revenues)

The own source revenues of 2010 were in the amount of €3,297,324. Out of which, the own source revenues carried forward from 2009 were in the amount of €765,624, whilst the collected revenues for 2010 were in the amount of €2,531,700.

The main findings resulting from out testing in the category of revenues are presented as follows.

- Revenues were not regularly reconciled between the Directorates which generate revenues and the Revenues Officer. In particular, no reconciliation was made between the Directorate for Geodesy and Cadastre and the Revenue Officer within the Directorate for Finance. The Directorate for Geodesy and Cadastre did not maintain records electronically because its officers do not possess computer skills;
- In the Directorate for Geodesy and Cadastre we noticed that revenues from the tax on the measuring of land were registered in the Other Administrative Taxes code;
- In the Business Licences we noticed that the Municipality did not apply penalty interests on licences arrears; and
- No records were kept on debtors, respectively the accounts receivables, in any of the economic categories of revenues.

Conclusion

Failure of the Municipality to reconcile revenues may result in undervaluation or overvaluation of the own source revenues. An incomplete revenues register enables that an unreliable statement on the own source revenues is provided to the Management. The recording of revenues into wrong economic codes provides a misleading view on revenues as per departments. Moreover, failure to maintain registers on debtors increases the risk that the contracted obligations are not paid, e.g. receipts from rent, concessioning of public properties etc.

Recommendation 2

We recommend the Mayor to ensure that:

- Required reconciliations between different Directorates and the Directorate for Finance are made on a monthly basis;
- Relevant trainings for Municipal officers with no computers skills are organised;
- All revenues are recorded in their respective codes;
- Own source revenues are completely recorded in the registers; and
- Accounts receivables are recorded in the registers.

VI.2 Expenditures

2.1 Purchases through procurement

Payments in excess of the contract's value

In the Contract "supply with oil in the Family health Care Centre" a payment was made for 8,110 litres but 7,785 litres were received. The average supply price was €1.07/litre, there was an overpayment of €348.

In the Contract "Servicing of vehicles" we have found that payments were made for many items not found in the Technical Specification of the EO. The tested value was €8,948, whereas the value of items outside the contract was €7,589.

In the Contract "Construction of houses for returns and welfare cases under the program for return of refugees in Kosovo" in the value of €53,547 (total contract value), we found that the total amount of payments was €31,284. There was made a payment of €7,737 more than the value of the contract. This contract was reached for the construction of four (4) houses, but the Municipality had paid and constructed seven (7) houses more. According to the

Municipality, this project is financed by UNDP while the Municipality conducted only the procurement procedures. Further on, the Municipal officials claimed that the contract signed for 4 houses and payments made for seven houses without a contract was a mistake and such mistakes will not be repeated in the future. Hence, we have a non-adherence to procedures. The third payment was made only based on the minutes of the Supervision Body in the amount of €51,284 without having received the progress payment with the description of executed works.

Contract reached without sufficient funds and valid performance security

The contract "Construction of the road from the OSCE building to the roundabout to Vitomiricë" in the amount of €1,779,785 was signed without providing sufficient funds for this project beforehand. This performance security was requested by the contracting authority for one year, while the company provided it for four months only.

Projects financed without proper supervision

In the project "Widening of the water supply network in nine (9) villages", we noticed that the Municipality had directly transferred €200,000 in the account of IRD (International Relief and Development). Despite this payment, the Municipality does not possess any report or evidence on the extent of works executed by the EO. The project was co-financed by the Municipality with €200,000, the IRD with €155,000, and by the Regional Water Company "Hidrodrini" Pejë with €25,400. The Municipality as the largest provider of finances did not supervise whether the works were executed in accordance with the terms of the contract and Technical Specifications.

None of the projects was implemented in accordance with the dynamic plan

In the project "Construction of the road Pejë - Deçan", with a contract value of €1,468,428, delays have occurred in the project implementation. Similar cases have been found in other projects tested.

Conclusion

The aforementioned cases indicate serious failure in the control system. The Municipality has weak procurement control. The Contracts on capital projects are not sufficiently supervised by the Municipality. As a consequence, we found payments made outside the contracts, uncontrolled financing, and a number of other irregularities. All these facts the risk that the Municipality's funds are spent outside the legal framework, and even misused.

Recommendation 3

We recommend the Mayor to ensure that:

- All payments are made in accordance with Terms of the Contract;
- Necessary funds are provided before entering into contracts;
- The body supervising the capital project has the competence and verifies with adequacy all the quantities and quality of constructions and that the investor is timely informed on the departures from the project; and
- The contracted works are carried out in accordance with dynamic plan foreseen in the contract.

2.2 Remunerations (wages and salaries)

According to Treasury, the budget for wages and salaries was €8,297,236 during January-December 2010, out of which €8,264,596 or 99,6% were spent. The Municipality had quite an effective level of planning and spending in this economic category. In this stage, we tested some personnel files, out of which five were related to recruitment during 2010. During our examinations, we did not notice any relevant shortcomings for reporting.

VI.3 Subsidies and transfers

The budget 2010 for Subsidies and Transfers category was in the amount of €290,022, whilst expenditures were in the amount of €286,867. During the testing of some samples in this category, we noticed that the Municipality had no internal policy regulating the conditions and criteria that should be met for receiving a subsidy.

The key findings resulted from our testing are presented as follows:

- In six (6) cases we noticed that the Board of Directors had taken decisions regarding subsidies without having received and reviewed the request beforehand. In regard to the case of subsidising the judo gym, the request was made on 15/06/2010 whilst the decision was taken on 21/05/2010. According to a decision 29/01/2010, the amount of €5,000 was allocated to the Besa football club, while the request was made on 04/02/2010. Similar cases of decision making were noticed in the project “Participation in the books fair, Independence Day, Rugova Folk Ensemble, and the City Theatre for putting on a show”;
- In one case we noticed that a decision was taken by Municipality to allocate funds in the amount of €8,000 to the Ipon Judo Club. The funds were not transferred into the account of the Club. Instead, they were transferred into the private account of a Club member;

- In the majority of cases tested, we did not find any evidence proving the adequacy of subsidies given to the beneficiaries. The beneficiaries did not submit reports proving that the funds received were spent based on the request and projects the funds were requested for.

Conclusion

The Municipality has neither proper controls nor clear policies on the granting of subsidies. The decisions approved by the Board of Directors to allocate subsidies prior to receive and review the request, funds allocation without adequate rationale behind the project, and lack of feedback/reports on expenditures are some of the weaknesses that increase the risk that funds allocated from the Subsidies and Transfers category are not properly managed.

Recommendation 4

We recommend the Mayor to ensure that:

- Thorough analysis is conducted before subsidies are awarded, and to take measures in cases when subsidies are not given in accordance with the criteria set; and
- An internal regulation is drafted which would clearly specify the procedures, criteria, and controls on allocation of subsidies.

VI.4 Assets and debts

4.1 Capital and non-capital assets

The Municipality did not make a full valuation and registration of capital assets in 2010. According to the Accounting Register, the fixed assets' value was recorded in the amount of €3,842,312.

This amount was related to the assets registered only during 2010 and not to the carried forward value of all assets. The Municipality did not achieve to fully register all business buildings under use, although these building are property of the Municipality.

Conclusion

Based on our findings above, we conclude that the Municipality failed to record all its assets. Failure to completely register capital assets might lead to the misuse of the Municipality's assets and prevents the Municipality from correctly stating its financial position at the end of the year.

Recommendation 5

We recommend the Mayor to ensure that:

- Property, buildings, and equipments are completely registered in order to have a final register of all assets owned.

4.2 Debts

The statement of outstanding liabilities of the accounts receivables by the end of 2010 was €566,000. These liabilities were carried forward for payment in the budget year 2011. Some of the Directorates have exceeded their budget allocations, and this is what caused the outstanding liabilities which were then carried forward to be paid in 2011.

No adequate evidence on liabilities carried forward from 2009

The Municipality did not maintain accounting registers which would reflect the invoices paid during 2010 for the servicing of debts carried forward from the previous years. KFMIS is the main financial information source in the Municipality. The Municipality has no internal accounting system, which would provide detailed information on each account payable.

Conclusion

The lack of detailed information on paid invoices increases the risk that, when payment is made by the Municipality, the invoice is paid more than once.

Recommendation 6

We recommend the Mayor to ensure that:

- Complete and accurate records are kept by the Finance Department and that all paid and unpaid invoices are registered.

VII. Management Control

VII.1 Internal Control Systems

Challenges described above indicate weaknesses in the Municipality's internal control. This shows that control improvements measures within the Municipality need to be taken. The weakest points of internal control, are in the registration, reconciliation, recording of revenues into wrong codes, procurement rules, payments outside contracts, insufficient monitoring of projects, and contracts entered into without funds provided beforehand. Substantial shortcomings are noticed in the financial controls: irregular certification of payments and allocation of subsidies without clear criteria and procedures in place, invoices left unpaid and unclear evidence on outstanding liabilities carried forward from last years.

In addition, the Municipality has no complete and accurate evidences on assets. Under such circumstances, it is impossible to have proper assets management.

Conclusion

Our conclusion is that the current controls do not provide assurance that the Municipality's operational and administrative activities are carried out in full accordance with the objectives and responsibilities of the Municipality.

Recommendation 7

We recommend the Mayor to ensure that:

- The internal control system will be reviewed and that adequate measures are proposed to be taken in order to secure that the reestablishment of controls enables the elimination of all weaknesses and shortcomings identified in this report.

VII.2 Internal Audit

The Municipality of Peja has structured the Internal Audit Unit. This Unit consists two auditors and the Director. The IAU had prepared the strategic plan and the annual plan for year 2010. The IAU planned to conduct nine (9) audits during 2010, out of which eight (8) were completed. These audit reports carried out during 2010 were mainly related to the period 2009. The IAU did not carry out an audit of transaction during 2010. Neither did we notice any willingness of the Municipality to implement the recommendations.

Moreover, we noticed that the Municipality has not yet established the Audit Committee.

Conclusion

The audits conducted for the 2009 period do not add value to the processes that are already ended. The internal audit should rather focus more on current activities in order to prevent errors and mistakes of the organization. Failure in addressing the audit recommendations indicates a poor functioning of internal audit.

In addition, the lack of the Audit Committee reflects on the quality and contributions of the IAU.

Recommendation 8

We recommend the Mayor to ensure that:

- Periodic audits will be carried out by IAU during one year period and that the recommendations given are addressed as they should; and
- The Audit Committee is established as soon as possible, which would ensure implementation of IAU and OAG recommendations.

VIII. Overall Conclusion on the Municipality Management

Overall Conclusions

Our overall conclusion is that the Municipality's financial management and controls have many weaknesses and shortcomings. The abovementioned findings are as a result failures in some areas. Unclear situation of revenues, unclear payments on capital projects, contracts entered into without providing funds, are some of the signals that the Management is fully controlling the operational activities. Moreover, weak control is noticed in the monitoring of projects and delays in their implementation up to the payments made under no contract in place at all, as in the case of building houses where over €78,000 were paid outside the contract. The Municipality's Management did neither apply control/monitoring mechanisms when subsidised the amount of €200,000 as a form of co-financing to provide water for some villages.

All in all, the Municipality has no clear and complete statements of its assets, properties, and equipments. Neither an annual valuation nor inventory of asset was made. This shows that there is the possibility that the Municipality's assets are mismanaged, lost, or even misused.

Based on what we said above, we believe that the overall controls should be substantially strengthened and improved.

Overall Recommendation

We recommend the Mayor to ensure that: After having analysed our findings in the report, a set of measures is issued and that all the Municipality's Administrative Departments are given the obligation to undertake the appropriate measures in eliminating the indentified weaknesses

Annex I. The Municipality's comments and OAG response

The Management of the Municipality has been given the possibility to give comments on the draft of this report.

The Management of the Municipality has acknowledged our findings and conclusions presented in the audit report on the AFS for the year 2010.

They are committed to make every effort to address all recommendations given.

Annex II. Different types of Audit Opinions applied by OAG in the Annual Audit Report 2010

(extract from ISSAI 400)

9. 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.

10. 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.

11. 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.

12. An auditor may **not be able to express an unqualified opinion when** any of the following circumstances exist and, in the auditor's judgement, 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.

13. 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.

14. 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.

15. 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.

16. 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.