



REPUBLIC OF KOSOVA
OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE ISTOG
MUNICIPALITY FOR THE YEAR ENDED 31 DECEMBER 2012

Pristina, June 2013

The Office of the Auditor General (OAG) undertakes both Regularity and Performance Audits. The Auditor General Lage Olofsson, is the head of the OAG which employs around 140 staff. The Auditor General and the OAG shall be independent and certifies around 90 Annual Financial Statements each year, while undertaking other forms of audits.

Our Mission is to “Contribute to sound financial management in public administration”. We shall perform quality audits in line with internationally recognized public sector auditing standards and good European practices. We shall build confidence in the spending of public funds. We shall play an active role in securing taxpayers’ and other stakeholders’ interests in enhancing public accountability’

The reports produced by the OAG directly promote accountability as they provide a base for holding managers’ of individual budget organisations to account.

The General Auditor has decided on the audit opinion and report on the Annual Financial Statements of Istog Municipality by consulting with the Assistant Auditor General, Qerkin Morina, who supervised the audit.

The opinion and report issued are results of the audit carried out under management of the Audit Director, Florim Beqiri, supported by Mehmet Muçaj (Team Leader), Agim Sogojeva and Cyme Hoxhaj

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Executive Summary

Introduction

This report summarises the key matters arising from our audit of the 2012 Annual Financial Statements (AFS) of Istog Municipality. I would like to thank the Mayor and his team for their assistance during the audit process.

The examination of the 2012 financial statements was undertaken in accordance with the internationally recognised Public Sector auditing standards (ISSAIs) issued by INTOSAI. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements.

Our audit focus has been on:

- The AFS;
- Financial Management and Internal Control (including budget management and execution) and
- The Internal Audit System.

Opinion

The Auditor General (AG) reports his opinion to Parliament in the format set out in sub-chapter 2.3 – Audit Opinion. Annex I explains the different types of Opinions applied by the OAG. The AG's certificate includes an opinion as to the truth and fairness of the financial statements.

In our opinion, the Annual Financial Statements present a fair and accurate view in all material aspects except that:

- At the statement of receipts and cash payments, in the column payments from third parties, the municipality did not present any value. According to the notes that we have obtained, the payments' value is €80,000;
- In article 13, budget execution statement – cash inflow in the final budget column, the municipality presented own sources revenues in value of €1,009,000, while it should be €869,580. Thus, there is a difference of €139,420;
- Also in article 13: in cash outflow from Treasury accounts, the municipality did not appropriately present the final budget. It should be €8,242,781, while it presented €8,137,000. Thus, the difference of €105,781 is noticeable. **(ISSAI 400 Qualified Opinion)**

Emphasis of Matter

We also would like to pay your attention for the fact that the records and information presented at the disclosure of contingent liabilities and receivables were not accurate. The inaccuracies are as follow:

- In note 29 – contingent liabilities: municipality has not presented the contingent liabilities regarding court disputes in process. Therefore, the approximate value of contingent liabilities, according to the public lawyer, is €747,331;
- In note 34 – receivables: municipality has presented the amount of €962,000, while we identified that the receivables were €973,000.

Overall Conclusion

The level of work undertaken by the OAG to complete the 2012 audit is a direct reflection of the quality of the internal control environment implemented by management. Our overall conclusion in the context of financial management and control is that:

Significant internal control deficiencies exist within the Municipality. This is reflected in the poor quality AFS presented for audit, continued weaknesses in the operation of management controls in areas previously highlighted by the OAG and specific areas of concern across a range of Municipality activity/responsibility.

The audit recommendations are intended to support Istog Municipality in improving the financial controls and increasing other aspects the operational activity. We have considered the responses on our recommendations made in 2011. But, we judge that further actions are needed to address some significant recommendations of prior year.

The Istog Municipality has designed controls regarding revenues, but the implementation of these controls remains still a challenge.

Municipality should put emphasis on expenses controls which are proceeded through procurement. In the current audit we have identified irregular payments, delays in completion of the projects and weaknesses regarding subsidies monitoring processes.

Municipality has undertaken significant actions in assets recording compared to previous year, but it has still not succeeded to finalise and maintain a complete register of the assets of value above €1,000. However, we think the accountability should be strengthened in all levels.

Our key recommendations to the Mayor are as follows:

Annual Financial Statements

- The Mayor should ensure that the AFS preparation plan includes all relevant information in accordance with standards and applicable legal requirements..

Financial Management and Control

- The Mayor should have a proactive approach towards revenue collection by assessing the age of debts, determining a recovery process supported by legal remedies and by promoting awareness campaigns about the Municipality focus in this area;
- The Mayor should review the road construction project in Vrelle in order to figure out why double payments had been executed and strengthen controls over payments. The supervision of the funded projects should be taken into account in order to reassure that the work is being conducted under the terms and conditions of the contract;
- The Mayor should ensure that effective processes on contract management are implemented so the project deadlines are being followed otherwise apply contractual penalties where appropriate to support this project;
- The Mayor should ensure that a Regulation on Transfers and Subsidies will be issued specifying conditions, criterias, procedures, priorities, proper documentations, the method of reporting so that fund from this category are spent in fairer and transparent manner;
- The Mayor should ensure that a special committee for assessing real estate property will be established and complete assets value will be listed in Financial Statements.

Internal Audit System

The Mayor should ensure that regarding 2013 internal audit, the IAU will develop and implement a risk based audit plan providing estimation to the management over the operation of internal controls in all significant areas. The Action Plan should identify responsible officials and timescales for actions that need to be taken for a proper implementation of the recommendations. Consideration should be given to the early establishment of an Audit Committee.

Management's response:

Management have confirmed agreement will all our audit findings and have committed to address our recommendations.

1 Audit Scope and Methodology

It is the responsibility of the Management to prepare financial statements under the International Public Sector Accounting Standards (IPSAS) for 'Financial Reporting under the Cash Basis for Accounting'. The Office of the Auditor General is responsible for carrying out a Regularity Audit which involves the examination and evaluation of Financial Statements and other financial records and expression of opinions 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
- All matters arising from or relating to the audit.

Audit work undertaken reflected our audit risk assessment for Istog Municipality. We have considered our understanding of the organisation, the extent to which management controls can be relied upon and the level of detailed testing required when determining the overall testing required to provide the necessary level of evidence to support the Auditor General's opinion.

The following sections provide a more detailed summary of our audit finding with emphasis on observations and recommendations in each area of review. An assessment of Management Responses to recommendations made in 2011 is at Annex II.

We have included the significant and other, less significant findings arising from our audit. For completeness we have included issues identified at the month 9 audit where they remain relevant. Our findings are defined as:

Significant - major issues for the attention of those charged with governance and senior management which may have the potential to result in a material weakness in internal control; and

Other - weaknesses identified in our audit where action will offer the potential for improvements to the efficiency and effectiveness of internal controls.

Our procedures included a review of the internal controls and accounting systems and procedures 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.

2 Annual Financial Statements

Our review of the Annual Financial Statements (AFS) considers both compliance with the reporting framework and the quality and accuracy of the information recorded in the financial statements. We also consider the Declaration made by the CAO and Chief Financial Officer when the draft AFS are submitted to the Government.

The declaration regarding presentation of financial statements incorporates a number of assertions relating to compliance with the reporting framework and the quality of information within the financial statements. A number of the declarations are intended to provide assurance to the Government that all relevant information has been provided to ensure that a comprehensive audit can be undertaken

2.1 Compliance with the Reporting Framework

Overall Conclusion

The AFS are not prepared fully in accordance with the requirements of Financial Rule no. 07/2011, and IPSAS "Financial Reporting under the Cash Basis for Accounting."

Description

The AFS must comply with a specified reporting framework. We noted that the:

- AFS were prepared within the framework of time and submitted to the Ministry of Finance;
- AFS were signed by Chief Administrative Officer (Mayor) and Chief Financial Officer;
- AFS were submitted only in Albanian;
- AFS were prepared in hard and electronic copy; and
- Municipality prepared and submitted regular quarterly reports to the Minister of MoF in 2012 with the exception of the fourth quarter.

While some issues raised during our nine (9) month audit relating to the reporting framework in our memo dated 08/11/2012 have been addressed by the Mayor, there remain omissions as follows:

2.2 Quality and Accuracy of Information Presented in the Annual Financial Statements

Overall Conclusion

AFS were not prepared in accordance with the requirements of Financial Rule no. 07/2011, and IPSAS "Financial Reporting under the Cash Accounting." They contain incorrect and inaccurate information.

Description

During our audit work, we required from the management to make adjustments in the draft AFS. Information gaps or inaccuracies were noticed in particular at: presentation of third party payments, own source revenues and disclosures. Although the Municipality has made adjustments, they still contain numerous errors and inaccuracies. As a result of this we did qualify the opinion.

Findings and Recommendations

1. Issue - Process of Drafting the Financials Statements - Priority Significant

Finding

In Article 12: Statement of cash payment receipts, Municipality has not introduced payments from third parties in the amount of € 80,000.

In Article 13: Statement of budget execution - cash entries, in the final budget column has introduced own source revenues of €1,009,000 which should be €869,580. So there is a difference of €139,420. Also, in the collected own source revenues column, there's an incorrectly presented value. The presented value of €840,000 from own source revenues collected should be €764,843. So it is a difference of €75,157;

In Article 13: The cash flow from Treasury accounts, the Municipality has not presented its final budget properly. There should be the value of €8,242,781 while the amount presented is € 8,137,000. So, there is difference of € 105,781.

Even AFS disclosures are not presented properly. Differences are presented below:

Note 11 - Capital Investments: the Municipality presented €2,094,000 but that should be €2,092,000;

Note 15 - Own Source Revenues: the Municipality presented the amount of €763,100 and should be €764,843;

Note 29 - Contingent liabilities: the Municipality did not present contingent liabilities related to litigation in process. Therefore, according to public counsel, the approximate value of contingent liabilities is € 747,331;

Note 34 - Receivables: the Municipality presented the amount of €962,000 while we identified that accounts receivable are in the value of €973,000.

Risk

Incorrect presentation of accounts leads to misunderstanding of the Municipality's financial state, and towards the possibility of misunderstanding future budget requests.

Recommendation 1

The Mayor should ensure that AFS are prepared in complete harmony with the Treasury Rule and that they present true and fair state. In case of ambiguities in the drafting of statements, municipal officials should consult with officials of the Ministry of Finance or should receive training in this area, so that the same mistakes are not repeated.

2.3 Audit Opinion

In our opinion the Annual Financial Statements present a true and fair view in all material aspects except of:

- At the statement of receipts and cash payments, in the column payments from third parties, the municipality did not present any value. According to the notes that we have obtained, the payments' value is €80,000;
- In article 13, budget execution statement – cash inflow in the final budget column, the municipality presented own sources revenues in value of €1,009,000, while it should be €869,580. Thus, there is a difference of €139,420;
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- In note 34 – receivables: municipality has presented the amount of €962,000, while we identified that the receivables were €973,000.

3 Prior Year Recommendations

Overall Conclusion

Municipality's Management has taken last year recommendations under consideration, but has not been able to address at the required level more than half of them. This for us presents a concern, but also must remain a concern for the management.

Description

Our audit report for 2011 AFS, resulted in 9 (nine) key recommendations. The Municipality's Management prepared an Action Plan stating that all recommendations will be addressed.

At the end of our 2012 audit, we noticed that 2 (two) of them are fully addressed; 2 (two) have been partially addressed, and 5 (five) have not been addressed. For a more complete description of the recommendations and how they are addressed, see Appendix II.

Findings and Recommendations

2. Issue - Addressing Prior Year Audit Recommendations - Priority Significant

Finding Municipality did not manage to address even half of the recommendations given last year.

Risk Incomplete addressing of all recommendations increases the risk that internal control system has not been improved and further weaknesses exist in in some areas.

Recommendation 2 The Mayor should ensure that necessary measures are taken to address the recommendations by setting deadlines for the responsible staff, and to strengthen all lines of accountability.

4 Financial Management and Control

4.1 Introduction

Our audit approach is focused on understanding and evaluation of actions taken by management to ensure effective financial management and control. For individual financial systems, we seek to identify the extent to which actual controls are operating.

Control systems must be supported (marked) and clear guidelines and procedures must be approved by management, or by the Municipal Assembly. Effective controls help in better management of public finances, preparing reliable financial reports, maintenance of assets and ensure compliance with applicable laws and regulations.

4.2 Budget Planning and Execution

Overall Conclusion

The Municipality spent around 95% of the budget in accordance with applicable regulations and framework set by the Assembly. A lower rate of expenditures, about 90%, is seen at Capital Investments category, while other categories expenditures have been at acceptable levels.

Description

We have considered the source of budgetary funds for Istog Municipality and the expenditure of funds by economic categories and revenues collected. This is reflected in the following tables:

Table 1. Sources of budgetary funds - outturn against the budget

Description	Initial Budget	Final Budget	2012 Outturn	2011 Outturn	2010 Outturn
Sources of Funds	7,089,792	8,242,781	7,855,664	7,272,733	6,686,686
Government Grant - Budget	6,220,212	7,092,212	6,988,068	6,482,713	5,315,022
Carried forward from previous year ² -	-	245,373	233,888	178,714	281,365
Own Source Revenues ³	869,580	869,580	608,049	561,334	546,420
Domestic Donations	-	30,357	24,909	23,767	-
External Donations	-	5,259	750	26,205	543,879

The Final Budget differs from the initial budget by €1,152,988. This change is due to the transfer of the previous year revenues in the amount of € 245,373, donor grants in the amount of € 35,615, the Government of the Republic of Kosovo which allocated to the Municipality the amount of €700,000 and based on the request for additional budget directed to parliamentary commission for budget related to a capital project, was allocated the amount of €172,000.

Table 2. Spending of funds by economic categories - outturn against the budget

Description	Initial Budget	Final Budget	2012 Outturn	2011 Outturn	2010 Outturn
Spending of funds broken down by economic categories	7,089,792	8,242,781	7,855,664	7,272,733	6,686,686
Wages and Salaries	4,357,836	4,394,836	4,272,524	4,133,180	3,305,610
Goods and Services	585,037	1,044,210	1,019,243	600,535	661,107
Utilities	150,258	150,258	149,952	130,254	145,942
Subsidies and Transfers	123,977	388,284	322,123	96,541	109,762
Capital Investments	1,872,684	2,315,193	2,091,822	2,312,223	2,464,266

¹ Final budget - the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

² Municipality Own Source Revenues unspent in previous year carried forward into the current year.

³ Planned Own Source Revenues.

Budget is spent around 95% in the general level which can be assessed as quantitatively a very good performance.

Table 3. Own source revenues of Municipality collected (in Euro)

Description	Initial Budget	Final Budget	2012 Outturn	2011 Outturn	2010 Outturn
Own source revenues	869,580	869,580	764,843	809,189	715,285

As the table shows, 2012 revenues decreased by 5% compared to last year, while 88% of revenues planned are collected. Revenue expenditures are made in accordance with legal requirements and for the categories permitted by law (for Capital Projects, Goods and Services, Subsidies).

Findings and Recommendations

3. Issue - Budget Execution and Planning –Priority Significant

Finding While the overall budget execution is good and the reason for some under spends against budget can be explained the current level of budget execution could be improved in some areas. Greater clarity is also required related to expected revenues.

Risk Poor budget execution will result in inefficient resource utilisation across the public sector and it will reduce the effective implementation of expenditures plans in Municipality as will underachievement of planned revenue collection.

Recommendation 3 The mayor should review existing budget processes to determine what improvements can be introduced to ensure increased levels of budget execution particularly related to capital investments and, subsidies and transfer. Planned own source revenues should be critically review to determine likely collection.

4.3 Reporting Requirement

Overall Conclusion

The Municipality met the reporting requirements and respected the deadlines; therefore, we appreciate the work done in this area of reporting.

Description

We have concluded that Istog Municipality complied with the majority of external reporting obligations as follows:

- Budget request to MoF for financing capital projects;
- Quarterly reports including nine month financial statements on time;
- Draft and final procurement plan in time;
- Reports on debts submitted to the MoF;
- Action Plan on implementing the recommendations.

However, Municipality of Istog did not make an annual performance report on the performance of internal controls, or made a self-assessment report, as one of FMC required procedures. The Management as well as other stakeholders should be informed about the activities of the Municipality. Therefore, lack of these reports makes the understanding of the overall performance difficult.

Findings and Recommendations

4. Issue - External Reporting

Finding	While most required reporting is addressed by the Municipality there is scope to develop self assessment reports..
Risk	The lack of these reports makes the understanding of the overall performance of the Municipality difficult to assess.
Recommendation 4	The mayor should place priority on developing self reporting and other reports as required in 2013.

4.4 Revenues (including own source revenues)

Overall Conclusion on Revenues

Concerning revenues, Istog Municipality appears to have designed controls, but the implementation of controls remains a challenge. By referring to the above table (3), we see that the Municipality had a deviation from the planned revenue collection for 12% less, and 5% decrease compared collection of last year. This shows a negative trend, which should be addressed in the future.

Description

In 2012, revenues generated by Istog Municipality were a total of € 764,843. These are related to property tax revenues; construction licenses revenues; administrative fees; annual business taxes, etc.

Findings and Recommendations

5. Issue - Planned Revenues - Priority Significant

Finding In 2012, the Municipality planned to collect revenues in the amount of €869,580, while the collected amount was €764,843. This means that the Municipality did not make a good planning of collection nor it based on realistic parameters.

Risk Failure of revenue collection compared to the plan, leads to failures in management's decision-making for funding projects from this source. Therefore we'll have revenue under payment and deviation from objectives set in advance.

Recommendation 5 The Mayor should use many sources of information before they approve the own source revenues plan, such as: previous year collection plan, taxpayer's database and their paying power/ability.

6. Issue - Property tax and Construction Permits – Priority Significant

Finding

From property tax for 2012, the Municipality collected €236,068 (the collection plan of property tax revenues was € 230,000). For testing purposes, from this category, we obtained 13 samples with a value of €13,399 and we concluded that 6 (six) of them did not accomplish the municipal obligations, amounting to € 12,538. Also, the amount of uncollected debts over the years in this account amounts to €776,193. There seems to be an unclear strategy on future proceedings for this problem.

From construction permits for 2012, the Municipality collected revenues in the amount of € 69,258 (revenues planned from construction permits were € 120,000). We tested 7 (seven) samples of €37,216 and identified the phenomenon that companies equipped with construction permits did not respect the deadlines related to the payment of taxes for construction permits.

Risk

The amount of uncollected debts in the property tax account are nearly equal to the amount of own source revenues collected within one year. In addition, non-payment of taxes within set deadlines, contributed to the low rate of revenue collection. This affects the Municipality's overall balance, with a final impact on failure of financing projects planned from this source.

Recommendation 6

The Mayor should have a more proactive approach towards this problem. Measures proposed are: analysis on debts age, problem reasons, taxpayer's purchasing power and commitments on the deadlines for payments, awareness campaigns and more determined actions of the revenue relevant factors.

Also, the controls on construction permits tax payments must be strengthened, so that they are paid in accordance with the terms established by the Municipality.

7. Issue - Revenue recording in inadequate codes – Priority other

Finding	We have identified that invoicing for annual business fees was done in the economic code 50202. Also, lease revenues were recorded in economic code 50290, urban license fees were recorded in the code 50009.
Risk	This increases the risk that accounts do not represent true and fair view of the Municipality's financial state.
Recommendation 7	The Mayor should ensure that revenues are recorded in the appropriate codes, through the guidance of staff and the establishment of appropriate controls.

4.5 Expenditures

Overall Conclusion on Expenditures

The Municipality should place emphasis on controls over expenditures. In the current audit we identified double payments, delays in completion of the projects and weaknesses regarding subsidies monitoring processes.

4.5.1 Procurement

Description

Budgeted amount for Capital Investments for 2012 was €2,315,193, while the Municipality executed €2,091,822 or 90% of the budgeted amount.

We have analyzed whether Capital Investment projects have been included in the PIP and in the medium term expenditure framework. Also, we reviewed whether there were any changes during the year related to the projects planned for this year. We have noticed that after budget review, the Municipality withdrew several capital projects out of PIP and finalised two projects, which were not in compliance with the budget law.

In 2012, Istog Municipality entered into around 108 contracts for works, goods and services, totalling up to €1,815,273. In order to test the compatibility with the current legislation, we examined 23 samples of payment in the amount of €812,528 and 8 (eight) samples of procurement procedures covering €514,245. During our tests we have identified the following:

Findings and Recommendation

8. Issue - Double Payments Conducted for Vrellë Road Construction - Priority Significant

Finding Regarding the road construction project in Vrellë - the Municipality entered into contract in the amount of €142,000, while the winning bid was in the amount of € 279,284. This was done due to lack of funds. We have also identified that the Municipality paid twice the amount of €47,119. This amount was paid once for the first instalment and one time for the second instalment. Some of the positions of the second instalment paid were same as the positions of the first instalment.

Risk Double payments are irregular and there are failures of budget controls and of the certification process. This may cause financial loss to Municipality, by not receiving the value for money.

Recommendation 8 The Mayor should review the case to determine why such payments have occurred and should strengthen controls over payments. Project supervision controls and certification function should prevent these failures and irregularities. Accountability for such cases should be implemented.

9. Issue - Project execution delays - Municipal Administration Building-Priority significant

Finding Municipality entered into a co-financing contract with MESP on 02.09.2011 for the construction of a floor on the municipality building in value of € 256,234. According to the co-financing agreement, the Municipality was obliged to finance €56,234, while MESP would finance €200,000. Under the terms of the agreement, the project should have been completed within 90 working days. We have observed that the request for technical acceptance of works was made on 19.09.2012, which indicates a delay longer than one year. Construction delay was not justified, and the Municipality did not apply penalties against the economic operator.

Risk Poor monitoring of contracts caused long delays in project implementation. This increases the risk that projects will not be finalised within projected time, with implications on budgetary trends.

Recommendation 9 The Mayor should apply penalties for unjustified delays in accordance with the agreement terms. Contract violations should be monitored and legal solutions should be applied in continuous basis.

10. Issue - Contract: Contract awarded to the ineligible operator - Priority significant

Finding In the Contract "Supply with two used vehicles" in the amount of €21,600, the Municipality awarded the contract to the ineligible economic operator. The operator lacked references for the past three years.

Risk This increases the risk of selecting inappropriate operators which do not provide reliable services.

Recommendation 10 The Mayor should determine the reason of not being in compliance with the procurement procedures and should strengthen controls in order to avoid such actions in the future.

4.5.2 Remunerations (Wages and Salaries)

Description

Wages and Salaries are paid through a centralized system (Payroll). Controls operating at the local level from the Municipality are related to: a) control performances on payments every month by signing the payroll ,b)verification through forms on possible changes occurrence, and c) budget revision for this category and reconciliations with the Treasury.

For this category we tested over 48 samples in order to assess compliance of payroll system with MPA's payroll system. We have also reviewed whether the officials' positions and coefficients are in compliance with the form of payroll system and the wages list. We do not have any findings to be reported.

Findings and Recommendations

11. Issue - Personnel data - Priority other

Finding We have noticed shortcomings within employee's files, as follows: in 5 (five) files, at act decisions are missing ranks or multipliers, in 4 (four) cases, within the Directorate of Education, there were employments without public announcements and there is a lack of electronic files maintenance.

Risk This increases the risk of improper payments occurrence, undermines the transparency of the recruitment process and jobs may not be offered to the best candidates, as well as makes the personnel files management more difficult.

Recommendation 11 The Mayor should take appropriate measures to eliminate these shortcomings, in order to avoid improper payments occurrence, as well as to increase the transparency of recruitment.

4.5.3 Subsidies and Transfers

Description

For the year 2102, for Subsidies and Transfers, Municipality budgeted the amount of €338,284 from which €322,123 are spent. These subsidies are mainly appropriated for public entities and non-public entities (individual) upon Mayor's decisions. Although in the absence of sufficient legal base, the Municipality applied different controls by requesting preliminary information as: a) conceptual project, b) expenditures plan and c) final financial reports on the manner of funds expenditure.

We have tested 17 samples in the amount of € 23,882, in order to verify the process of granting subsidies and reporting on how given funds were spent.

Findings and Recommendations

12. Issue - Lack of sufficient legal base and lack of expenditure reports - Priority Significant

Finding According to the Mayor, the Municipality does not have a written regulation that determines the manners of appropriate allocation of subsidies.

The Municipality granted a subsidy for the "Decoration of Istog Town" in the amount of €2,625. In the file there were no reports from the beneficiaries regarding the expenditure of these funds. Also, the subsidy for the project "Networking Kosovar and International Artists" in Rome, in the amount of €1,526 an expenditure report is missing.

Risk Expenditures on appropriate subsidies and transfers in the absence of an internal regulation, affect failures in reaching particular purposes, and as such, are in conflict with the Financial Rule. Lack of interior policies/rules also reflects the absence of the procedures that should be followed in case of subsidies.

Recommendation 12 The Mayor without any further delay should adopt a rule which clearly specifies the subsidy criteria and resources. Also, the Mayor should ensure that better monitoring of subsidies is conducted in order to ensure that subsidy funds have reached the right destination.

4.6 Assets

Overall Conclusion on Assets

The Municipality has taken significant measures in property registration, compared with the previous year, but still has not managed to finalize and maintain a complete registry of assets valued over €1,000. Moreover, seems that Municipality is not able to establish appropriate management controls regarding assets, as it has not reviewed any report on assets condition during the year.

4.6.1 Capital and non capital assets

Description

Our audit found that Municipality made certain efforts in order to identify its real estate properties.

Findings and Recommendations

13. Issue - Financial assets are not recorded in KFMIS registry - Priority Significant

Finding The Municipality does not possess a complete registry of assets, because it failed to register assets purchased in 2012. We identified that the value of unrecorded assets is €256,507. In 2012, the Municipality established a committee in municipal level aiming to assess its assets.

Risk Incorrect presentation of asset's value leads to misunderstanding of the Municipality's financial state and with the possibility of misunderstanding future budget requests.

Recommendation 13 The Mayor should ensure the establishment of a committee, as soon as possible, which would assess and record correctly and completely all fixed assets owned by the Municipality. Also, management must monitor the results of the assessment and must carry them in asset registry.

4.7 Handling of debts

Overall Conclusion regarding Handling of Debts

The Municipality reported its liabilities in compliance with rules of the Treasury in the Ministry of Finance and has good controls in this area, since from the moment invoices are received from the economic operators; they are preceded without delay to the finance department for payment.

Description

Statement of outstanding liabilities to suppliers, at the end of 2012, was in the amount of €31,430. This amount seems to be very low; although management's efforts should be that they are reduced to minimum.

Findings and Recommendations

We have no recommendations in this area

5 Internal Audit System

Overall conclusion on internal audit system

Internal audit unit has done a good job, by making reports on certain areas, although with the focus in 2011, and only one report for the current year.

Description

In 2012, IAU was scheduled to perform 5 (five) audits, while 3 (three) audit reports were finalized on: 1) assets management audit; 2) audit of revenues in the health directorate, covering 2011 and 3) procurement process audit for 2012.

Findings and Recommendations

14. Issue - Lack of Action Plan and non establishment of the Audit Committee - Priority Significant

Finding We noticed that the management did not make any action plan to address recommendations of the IAU. Also, the Municipality has not established Internal Audit committee.

Risk Failure to provide an action plan and not addressing the recommendations increases the risk that same weaknesses are repeated, and, in certain cases, may even result in financial loss. The absence of an audit committee reflects the lack of controls on internal audit.

Recommendation 14 The Mayor should draft an Action Plan, which should be implemented by confirming the officials responsible, and the deadlines of performance. Also, the establishment of an Audit Committee is recommended.

6 Overall conclusion

Our overall conclusion reflects our review on controls related to AFS, Financial Management and Control, and Internal Audit System.

Istog Municipality has many shortcomings and failures of controls in many areas. The importance of public finances internal control is little understood by the Management and professional staff of the Municipality. Municipality continues the same practice as last year. Reasons for qualifying the opinion for 2011, are repeated, are even more emphasized.

The level of work undertaken by the OAG to complete the 2012 audit is a direct reflection of the quality of the internal control environment implemented by management. Our overall conclusion is that:

Significant internal control deficiencies exist within the Municipality. This is reflected in the poor quality AFS presented for audit, continued weaknesses in the operation of management controls in areas previously highlighted by the OAG and specific areas of concern across a range of Municipality activity/responsibility.

The AFS are not prepared fully in accordance with the requirements of Financial Rule no. 07/2011, and IPSAS "Financial Reporting under the Cash Basis for Accounting. We also analysed the quality of the information presented in the AFS and found this to be incomplete and inaccurate in a number of areas

Audit recommendations are barely addressed by Management. In 2010, out of 5 (five) recommendations given, only 1 (one) was addressed, and in 2011, out of 9 (nine) recommendations only 2 (two) of them were fully addressed. We believe that this kind of management approach should eventually change.

Istog Municipality has designed appropriate controls related to revenues but the effective implementation of these controls remains a challenge. The Municipality should place emphasis on controls over expenditure particularly related to Procurement. In the current audit we identified double payments, delays in completion of the projects and weaknesses regarding subsidies monitoring processes

The Municipality has taken significant measures in property registration, compared with the previous year, but still has not managed to finalize and maintain a complete registry of assets valued over € 1,000.

Control weaknesses identified, mentioned above, are not identified by Internal Audit, thus showing the non-support from the Internal Audit System in developing an effective internal control environment.

Therefore, we recommend the Mayor:

To form a working group aiming to analyze thoroughly all findings of this report and propose appropriate measures to eliminate all shortcomings, weaknesses and irregularities identified. A review of the Internal Control System is unavoidable.

Annex I: Explanation of the different types of opinion applied by the OAG

(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.

Annex II: Prior year recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
1.CFO	Preperation of financial statements by collecting and reporting on appropriate information and their preparation in Serbian.			No
2. CFO	Ensuring information related to third party payments.			No
3. Own source revenues	Improvement of accounting and invoicing system to ensure solid, efficient and effective controls on invoicing and revnues.		Yes	
4. Expenditures in total. (Capital Investments and Goods and Services)	To Ensure further actions to improve control procedures over expenditures and payments and those to be in fully compliance with legislation applicable.			No
5. Accounts receivable	Detailed disclosed of accounts receivable and the note should contain detailed data on debtors.	Yes		

6. Assets	Keeping comprehensible register of property, plant and equipment		Management is committed to identify its real estate, but still remains a challenge for the municipality to record its assets in KFMIS.	
7. Directorate of Finances	To ensure improvement in control procedures over the expenditures and payments to be in compliance with the current law. Payments should be executed within timeline.	Yes		
8. CFO	Preparation of financial statements by collecting and reporting on appropriate information and their preparation in Serbian.			No
9. Internal Audit	Establishment of the Audit Committee			No
10. Overall conclusion	Raising awareness on controls amongst managers and entire Municipality's staff, drawing clear policies and procedures for all processes such as strengthening responsibility and accountability measures in all levels of the organization.		By strengthening internal control system, Management has taken steps towards positive processes by appointing responsibility and accountability in different levels, but, should further increase responsibility in all levels in order to achieve organisation's set objectives.	