



**REPUBLIC OF KOSOVA**  
**OFFICE OF THE AUDITOR GENERAL**

**Document No: 22.4.1-2013-08**

**AUDIT REPORT**  
**ON THE FINANCIAL STATEMENTS OF THE MUNICIPALITY OF**  
**ISTOG**  
**FOR THE YEAR ENDED 31 DECEMBER 2013**

**Prishtina, June 2014**

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 145 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 Auditor General has decided on the audit opinion and report on the Annual Financial Statements of Municipality of Istog in consultation with the Assistant Auditor General Qerkin Morina who supervised the audit.

The opinion and report issued are a result of the audit carried out under the management of the Audit Director, Florim Beqiri, supported by Mehmet Muçaj (Team Leader), Qëndresa Sogojeva, Mexhit Ferati and Evetar Zeqiri.

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## Executive Summary

### Introduction

This report summarises the key findings from our audit of the 2013 Annual Financial Statements of Istog Municipality which determine the Opinion given by the Auditor General. I would like to thank the Mayor and his staff for their assistance during the audit process.

The examination of the 2013 financial statements was undertaken in accordance with the internationally recognised Public Sector Auditing Standards. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated 29.10.2013.

Our audit focus has been on:

- The compliance with the reporting framework and the significant risks to the Annual Financial Statements highlighted in the Audit Planning Memorandum;
- The response to our 2012 and earlier recommendations; and
- The Financial Management and Internal Control of Municipality of Istog (including budget management and execution and Internal Audit).

The level of work undertaken by the Office of the Auditor General to complete the 2013 audit is a direct reflection of the quality of the internal controls implemented by management.

### Opinion

Annex I explains different types of opinions applied by the Office of the Auditor General.

The opinion of the Auditor General is:

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

As an *Emphasis of Matter* the Registry of Fixed Assets is still not fully accurate as there are properties and buildings of the Municipality not recorded in the Accounting Register and not presented in the AFS. Projects in the amount of €447,842 which were not included in the AFS are: Kindergartens (€261,165), construction of pavements (€167,777) and a vehicle (€18,900). The registry of fixed assets does not affect any of the two Annual Financial Statements (Cash Receipts and Payments and Comparison of Budget and Actual Amounts) in line with IPSAS Cash based accounting.

**(ISSAI 200 Unmodified Opinion with an Emphasis of Matter)**

### **Overall Conclusion**

Based on the details presented in each section of this report, our overall conclusion is that:

The management of Municipality did not manage to establish an effective system of internal control. Furthermore, current controls operated poorly during 2013. In particular, we identified:

- Although the AFS addressed the majority of presentational requirements there were a number of omissions and inaccuracies in the AFS presented for audit. Some have been amended in the final version of the AFS but management chose to leave some items unadjusted.
- Significant risks in the Annual Financial Statements were inaccurate recording of assets, where we identified that assets in the value of €447,842 were not included in the Accounting Register;
- The recommendations from 2012 and previous years have not yet been fully addressed. This will result in continued control weaknesses/poor value for money/potential continuous financial losses; and
- Although we managed to take assurance in some account areas from effective controls of management, our assessment of Financial Management and Control revealed that there are shortcomings in some key activity areas such as in procurement where contracts were not managed satisfactory. The Audit Committee was not established, and the IAU did not manage to identify weaknesses and provide the level of assurance to the management concerning the key financial systems for 2013.

**The Auditor General's key recommendations are as follows:**

**The Mayor should ensure that:**

- The 2014 AFS Production Process formally incorporates management review of the draft account with specific focus on areas considered of high risk of error and/or areas where errors have been identified earlier;
- A revised action plan clearly sets out a timetable for addressing the recommendations made by the Auditor General with accountable staff members identified and initial focus on those areas of greatest significance;
- A detailed assessment of Procurement processes and controls is made to determine why weaknesses continue to occur and identify actions in order to address these weaknesses;
- The Mayor should work with IAU to develop a risk based plan that will provide assurance over all significant areas during 2014 and consider the opportunity to increase the number of staff at this unit; and
- Review the issue of establishing an Audit Committee in order that the role and supervision of the Internal Audit is strengthened.

**Management's response - audit for 2013**

The Management has agreed to all our audit findings and commitment themselves to address our recommendations.

# 1 Audit Scope and Methodology

It is the responsibility of the Municipality to prepare financial statements under the International Public Sector Accounting Standards (IPSAS) for 'Financial Reporting under the Cash Basis for Accounting' and other specific requirements. The Office of the Auditor General (OAG) is responsible for carrying out a Regularity Audit which involves the examination and evaluation of the Annual Financial Statements (AFS) and other financial records and expression of opinions on:

- Whether the AFS 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.

We have considered the extent to which management controls can be relied upon when determining the overall testing required to provide the necessary level of evidence to support the Auditor General's (AG) opinion and the focus of our audit.

The following sections provide a more detailed summary of our audit finding with emphasis on observations and recommendations in each area of review. For completeness we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

**High Priority** - issues which may result in a material weakness in internal control and where action will offer the potential for improvements to the efficiency and effectiveness of internal controls; and

**Medium Priority** - issues which may not result in a material weakness but where action will also offer the potential for 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. Findings considered low priority will be reported separately to finance staff.

## 2 Annual Financial Statements and other External Reporting Obligations

### Overall Conclusion

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

The declaration regarding presentation of the AFS incorporates a number of assertions relating to compliance with the reporting framework and the quality of information within the 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 Audit Opinion

#### *Unmodified Opinion<sup>1</sup> with Emphasis of Matter*

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

As an *Emphasis of Matter* the Registry of Fixed Assets is still not fully accurate as there are properties and buildings of the Municipality not recorded in the Accounting Register and not presented in the AFS. Projects in the amount of €447,842 which were not included in the AFS are: Kindergartens (€261,165), construction of pavements (€167,777) and a vehicle (€18,900). The registry of fixed assets does not affect any of the two Annual Financial Statements (Cash Receipts and Payments and Comparison of Budget and Actual Amounts) in line with IPSAS Cash based accounting.

**(ISSAI 200 Unmodified Opinion with an Emphasis of Matter)**

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<sup>1</sup> The term, “unmodified opinion” is equivalent to the term, “unqualified opinion” used in our previous year’s reports. The new wording is in accordance with the new INTOSAI audit standards (ISSAI 200). For more

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## 2.2 Significant risks to the Annual Financial Statements

### Description

Our Audit Planning Memorandum dated 29.10.2013 identified significant risks to the AFS related to the completeness of assets, Third Party Payments, and incorrect presentation of receipts (revenues) in the AFS.

These are risks of material misstatements which can result in modified opinion, including Emphasis of Matter.

Planned risk for presentation of receipts and Third Parties Payments in the AFS did not occur as the Municipality did not undertake appropriate actions to address this issue.

The risks of material misstatement that we identified relating to the completeness of assets occurred because management did not undertake any action to address the highlighted risk.

### Identified Risk

**Issue 1 – Assets owned by the Municipality are not identified and recorded appropriately resulting in a material misstatement in the assets note within the AFS – High Priority**

### Finding

We have assessed the controls implemented by management to prove the completeness of asset records in the context of capital expenditure in 2013 and previous years. In our interim memorandum we provided advice to management on the action required to ensure that the assets figure in the AFS was correct. However, the risk identified has materialised because management has been unable to implement the necessary improvements in internal control. The value of €10,556,261 presented as assets in the AFS was not correct as besides land were not included €447,842, kindergarten (€261,165), construction of pavements (€167,777) and a vehicle (€18,900).

**Recommendation 1 High Priority** - The Mayor should identify the reasons behind initial misstatements of assets and for failing to follow advices of the OAG. Proper processes should be established in 2014 to ensure that municipal assets are assessed and recorded in adequate registers.

## 2.3 Compliance with AFS reporting requirements

### Description

The AFS are required to comply with a specified reporting framework. We considered

- Compliance with Financial Regulation (FR) no. 03/2013;
- Requirements of LPFMA no. 03/ L-048;
- AFS were prepared within the timeframe and submitted to the Ministry of Finance (MoF);
- AFS were signed by the CAO and the CFO;
- AFS were submitted in Albanian and Serbian;
- AFS were prepared in hard and electronic copy; and
- Municipality prepared and submitted regular quarterly reports to the Municipal Assembly and to the Minister of MoF during 2013.

The above requirements were met with the exception of preparation of AFS in Serbian.

Initial AFS contained some errors. During the audit we gave suggestions to Municipality's management to make appropriate corrections, but we noticed that not all corrections were made by the management in the final version. These shortcomings are presented below.

## Issue 2 – AFS production process - High Priority

**Finding** In Note 30 - assets register is not accurate due to the fact that some assets were not recorded in the accounting register. The value of assets not recorded was €447,842. For more details, see section 2.2 of this report.

Note 34 - receivables were understated by €5,584.

**Risk** Annual Financial Statements were not complete, especially the part of assets and receivables. The accounting registers are insufficient to support management's decision-making processes and wider budget considerations.

**Recommendation 2** The Mayor should ensure that the 2014 AFS production plan formally addresses all compliance requirements related to the AFS, with specific focus on areas mentioned above. The Declaration made by the CAO and CFO regarding the AFS accuracy should not be submitted unless all necessary controls have been applied, before they are submitted to the Government.

## 2.4 Compliance with other external reporting requirements

### Description

The Mayor is required to address the following external reporting obligations other than producing AFS such as:

- Budget request;
- Quarterly reports including nine month financial statements;
- Draft procurement plan; and
- Reports on debts.

The Municipality fulfilled the above requirements, but it did not draft the plan for addressing recommendations given by the AG, and did not produce the self-assessment report.

**Recommendation 3** The Mayor should ensure that all external reporting obligations are met with a good quality and within the specified timeframes.

## 3 Prior Year Recommendations

### Overall Conclusion

The Management of Municipality did not sufficiently address the recommendations in the report on 2012 AFS. Due to this, most of the problems behind were repeated this year as well.

### Description

Our Audit Report on the 2012 AFS resulted in 14 key recommendations. The Municipality did not prepare an Action Plan for addressing AG recommendations.

At the end of our audit for 2013, five recommendations have been fully addressed; two are partially addressed; and seven have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II.

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### Issue 3 - Addressing Prior Year Audit Recommendations - High Priority

**Finding** Only a portion of prior year recommendations have been implemented because the Municipality does not have a formal process to manage and monitor the way that the AG's recommendations are implemented. The Management of Municipality was obliged to submit an Action Plan to the OAG within 30 days from publishing the report, but this Plan was not submitted.

**Risk** Failure to fully address recommendations indicates that same problems continue to exist in some areas since 2012, and that previous year recommendations are being repeated. Weaknesses in the area of procurement, irregular payments, and assessment of assets (lands) are repeated in a systematic manner and this increases the risk for financial losses to the Municipality.

**Recommendation 4** The Mayor should draft a plan for addressing the recommendations and discuss with accountable staff members on how to address recommendations given, to set an optimal feasible deadline, and focus on areas of greatest significance (or priority areas).

## 4 Financial Management and Control

### 4.1 Overall Conclusion

Our audit approach is focused on understanding and evaluating the actions taken by management to secure effective financial management and control and the results of this action. For individual financial systems we seek to identify the level at which actual controls operate. We consider that controls are well designed, but were not as functional. This requires an assessment of structures, processes, and accountability lines introduced by management including the role undertaken by Internal Audit.

We found that while controls over the revenue planning are poor and were not analysed in a sustainable manner. The controls over a range of expenditure areas require further enhancement to prevent the Municipality from suffering financial losses, poor value for money and ineffective project management. The main areas where most improvements are required are procurement process, monitoring of subsidies, assets recording and stronger commitment for implementation of the audit plan and functionalise the internal audit committee.

### 4.2 Good Governance

The internal financial reporting within the Municipality is regulated through the applicable legal framework. Weaknesses in high-level controls identified by the AG suggest that the management should take a proactive approach in addressing these issues.

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#### Issue 4 - Weaknesses in high level management controls - High Priority

**Finding** The audit of 2013 identified weaknesses in controls in all economic categories, particularly in the year-end period. These weaknesses were not effectively identified through internal oversight or reported to the management, or when identified, no appropriate actions were taken.

**Risk** Weaknesses in functioning of management controls in the financial system, and concentrating most of expenditures at the end of the year reduce management's ability to actively manage municipal activities and reduce the effective budget control.

**Recommendation 5** The Mayor should ensure that an appropriate governance structure is implemented, through which the senior management is informed on the control shortcomings and manages them actively. This process should be supported by submitting self-assessment report required by the MoF.

## 4.3 Budget Planning and Execution

### Description

We have considered the source of budgetary funds for the Municipality, spending of funds by economic categories and revenues collected. This is highlighted in the following tables:

**Table 1 Sources of budgetary Funds - outturn against the budget (in €)**

Description	Initial Budget	Final Budget <sup>2</sup>	2013 Outturn	2012 Outturn	2011 Outturn
<b>Sources of Funds</b>	<b>8,386,727</b>	<b>8,683,582</b>	<b>8,339,097</b>	<b>7,855,664</b>	<b>7,272,733</b>
Government Grant - Budget	7,486,727	7,486,727	7,406,811	6,988,068	6,482,713
Carried forward from previous year <sup>3</sup> -	-	168,280	144,464	233,888	178,714
Own Source Revenues <sup>4</sup>	900,000	900,000	683,436	608,049	561,334
Domestic Donations	-	50,386	48,789	24,909	23,767
External Donations	-	78,189	55,597	750	26,205

The final budget, compared with the initial budget, was higher by €296,855. This increase is a result of Revenues carried forward from the previous year by €168,280, and Donations in the amount of €128,575.

In 2013 the Municipality spent 96% of the final budget or €8,339,097 which compared with 2012 presents the same level of execution. Overall budget execution was well managed and it presents a satisfactory performance.

<sup>2</sup> Final budget - the budget approved by the assembly, which was subsequently adjusted for by the Ministry of Finance.

<sup>3</sup> Own Source Revenues unspent in previous year carried forward into the current year.

<sup>4</sup> Municipality revenues planned and collected in the current year which was used by the entity for financing its own budget.

**Table 2 Spending of funds by economic categories - outturn against the budget (in €)**

Description	Initial Budget	Final Budget	2013 Outturn	2012 Outturn	2011 Outturn
<b>Spending of funds broken down by economic categories</b>	<b>8,386,727</b>	<b>8,683,582</b>	<b>8,339,097</b>	<b>7,855,664</b>	<b>7,272,733</b>
Wages and Salaries	4,366,810	4,366,810	4,318,168	4,272,524	4,133,180
Goods and Services	871,138	890,847	864,385	1,019,243	600,535
Utilities	164,920	188,130	187,559	149,952	130,254
Subsidies and Transfers	450,000	459,000	359,903	322,123	96,541
Capital Investments	2,533,859	2,778,795	2,609,082	2,091,822	2,312,223

Explanations for changes in budget categories are given below:

While the level of expenditures for Goods and Services reduced by 18% compared with last year, the opposite occurred with Capital Investments which increased by 25%. This is an encouraging indication that the Municipality is oriented more on capital projects and improved citizens' services. However, performance improvements in the future still need to be focused on Capital Investments and Subsidies and Transfers, which during 2013 were spent at relatively low level (78%).

Each year Own Source Revenues are underspent as a direct result of budget underspending, given that Own Source Revenues are the last source of funding used. In 2014, the carried forward value of Own Source Revenues is approximately €189,000.

Other budget categories were spent within planned parameters.

**Table 3 Municipality's Own Source Revenues budgeted and collected in 2013 (in €)**

Description	Initial Budget	Final Budget	2012 Receipts	2011 Receipts	2010 Receipts
Own Source Revenues	900,000	900,000	848,542	764,843	809,189

The initial budget of Own Source Revenues did not reflect last year's receipts and other relevant factors. The table shows that collection of revenues was quite significant (94%). Compared with previous year, planned revenues were €80,000 or 11% higher.

We noticed that there is no close correlation between the level of planning and the level of invoicing from property tax. The Municipality planned to collect €260,000 from this source while it invoiced €300,000.

## 4.4 Revenues (including Own Source Revenues)

### Description

The Municipality collects several types of revenues, but the most important ones are those from property tax, construction licenses, administrative fees, revenues from rent etc.

In general, the Municipality to a certain extent established controls when it comes to recording and reporting of revenues. However, further improvements are needed in order to apply appropriate policies and mechanisms for collecting debts from previous years.

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### Issue 5 - Poor planning of revenues from property tax - Medium Priority

**Finding** The Municipality planned to collect revenues from property tax in the amount of €260,000; instead it collected €270,935, while the invoicing for 2013 was €300,676.

**Risk** There is insufficient consistency in revenue planning. The initial planning for revenues from property tax was lower by 15% than the amounts invoiced. Therefore, the level of the plan exceeded does not present the real performance in terms of revenues. On the other hand, outstanding debts from the property tax account exceed the amount of €800,000. This affects the overall balances of the Municipality, having the failure of planned projects' execution as a final impact.

**Recommendation 6** The Mayor should use relevant sources of information before approving the Own Source Revenues plan, such as: the trend of collections from previous years, the economic base of taxpayers and their paying capabilities.



## **Issue 6 - Issuing construction licenses not in compliance with legal requirements - Medium Priority**

**Finding** Planned revenues from this category were in the amount of €105,000 while the amount of €129,950 was collected. During our testing, we noticed that the Municipality issued construction licenses without calculating the tax. This way of issuing construction licenses is not in line with Law on Construction, namely Article 21, paragraph 3 where the party (the applicant) should initially provide proof for paying the tax set by the Municipality, and then the license is issued.

**Risk** Issuing construction licenses without meeting financial obligations to the Municipality, besides being in contradiction to the Law on Construction, is also followed by the risk that construction license fees are not collected and may have a negative impact on the Municipality's budget balances.

**Recommendation 7** The Mayor should review procedures for issuing construction licenses and ensure that construction license fees are paid before the license is issued.

## **4.5 Expenditures**

### **4.5.1 Procurement**

#### **Description**

During 2013, €3,473,466 was spent in the category of Capital Investments and Goods and Services through procurement. We have tested five procurement cases in the amount of €512,658 and 16 payments in the amount of €547,656.

Our audit identified several weaknesses in the procurement process on which controls were not implemented effectively.

We have verified whether the Capital Investment Projects were included in the Public Investment Program (PIP) and in the Medium Term Expenditure Framework. In addition, we also reviewed whether there were any changes throughout the year in terms of projects planned to be implemented during the year. We have no issues to raise in this report.

## **Issue 7 - Awarding contracts to ineligible Economic Operators - Medium Priority**

**Finding** In four cases we noticed that the Municipality carried out procurement procedures in lack of eligible Economic Operators (EOs). The cases identified were:

- a. In the contract "Supply with medicines, dental and laboratory material for the needs of Family Health Centre" with price per unit, the winning company provided an expired license for wholesale and circulation of medicinal products;
- b. In the contract "Maintenance of mountainous roads in the amount of €9,990, the requirement on the adequacy professional staff of the winning company was missing;
- c. In the contract "Asphalting of the road in the neighbourhood Ali Hajdaraj" in Istog in the amount of €64,227, the winning company did not have notarised documents; and
- d. In the contract "Supply with firewood for municipal institutions" with price per unit, the winning company did not provide the price for one of the two items in the technical specification.

**Risk** Awarding contracts to ineligible EOs increases the risk of products not being at the expected quality and contractual obligations not met. In addition, developing procedures in absence of minimum number of eligible EOs is not in line with the key principles of public procurement and does not ensure that the most favourable bidder in the competition was selected.

**Recommendation 8** The Mayor should ensure that no economic operator is rewarded with contracts unless is eligible and where controls were not applied, reasons are determined and the responsibility is distributed to the accountable staff.

## **Issue 8 - Payments for unfinished works - High Priority**

**Finding** The payment for the project “Regulation of pavements and bicycle path Istog-Gurakoc” in the amount of €167,777 was fully made although the works were not completed. On 12.05.2014 we identified that the works for lighting paid in the amount of €7,423 on 19.12.2013 were not completed, while the Municipality (Technical Acceptance Committee and Supervisor) approved the project as completed. We informed the Mayor on the shortcomings identified regarding the implementation of project, and after this, he took measures to eliminate the abovementioned shortcomings.

**Risk** The contract management was accompanied with shortcomings. Such payments are not in line with the financial rules on spending of public money, furthermore, carrying out payments before the contracted works are completed increases the risk that projects are not completed or additional costs are incurred.

**Recommendation 9** The Mayor should review the case and determine why the failures in this process occurred, increase monitoring controls to ensure that such failures are not repeated in the future and take administrative measures as needed.

## 4.5.2 Remunerations (Wages and Salaries)

### **Description**

Wages and Salaries are paid through a centralised system. Controls operated locally by Municipality relate to a) monthly checking of payments by signing the payroll list, b) verifying possible changes that may occur through forms, c) reviewing the budget for this category and reconciliations with the Treasury.

From this category, we tested 45 samples to review the compliance of the payroll list with the payroll system in the Ministry of Public Administration (MPA). We have also considered whether the positions and multipliers of officials are in accordance with the form of the payroll system and the payroll list.

We have no issues to raise in this area.

### **Recommendation**

We have no recommendations in this area.

### 4.5.3 Subsidies and Transfers

#### Description

The Municipality planned the budget for Subsidies and Transfers in the amount of €459,000 whilst €359,903 was spent. We tested 16 samples amounting to €128,097 or 36%.

Planning of Subsidies and Transfers needs to improve in order not to have significant surpluses as in the reporting year where 22% of the budget for subsidies was not spent.

The Municipality did not follow the previous year recommendation to draft an internal regulation which would determine the criteria for awarding of subsidies and reporting requirements on how benefited funds were spent. Supporting documents were not well structured.

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#### Issue 9 - Failure to approve the internal regulation for granting subsidies - Medium Priority

**Finding** Despite our earlier recommendations, the Municipality did not draft an internal regulation for granting subsidies, as subsidies were given under the Mayor's decision. Out of nine cases tested, four of them did not provide relevant documents/reports to justify that expenses met the intended purpose.

**Risk** It is not certain whether planned expenditures for Subsidies and Transfers met the intended purpose. Lacks of internal policies/regulations reflect shortcomings in procedures which should be followed when granting subsidies.

**Recommendation 10** The Mayor should immediately adopt a regulation that clearly specifies the criteria, reporting format and sources of subsidy. In addition, better planning and implementation of the initial budget appropriations should be management's permanent objective.

## 4.6 Assets and liabilities

### 4.6.1 Capital and non-capital assets

#### Description

The Municipality did neither issue nor apply any adequate policies in order for collection of previous years' debts for property tax, business fees and construction licenses.

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#### Issue 10 - Accounts Receivable - High Priority

**Finding** The overall debt (account receivables) to the Municipality is €1,186,000. Most of these receivables relate to property tax in the amount of €879,000, and business operation tax in the amount of €180,000.

**Risk** Failure to collect revenues may result in the Municipality's inability to implement expenditures plans, and may also result in further difficulties to collect invoiced revenues.

**Recommendation 11** The Mayor should initiate a reassessment process, where all accounts are analysed in terms of age, significant amounts, real collection possibilities and take administrative measures as needed.

### 4.6.2 Handling of debts

#### Description

The Municipality managed debts well. Our audit conclusion is that handling of debts and controls over them were generally functioning well

The statement of outstanding liabilities not paid to suppliers at the end of 2013 was in the amount of €48,179. These liabilities are carried forward to be paid in 2014. The reason why these liabilities were not paid in time is due to lack of funds.

#### Recommendation

We have no recommendations in this area.

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## 4.7 The Internal Audit System

### Description

The Internal Audit Unit (IAU) consists of one auditor who also is the Director of the IAU. Considering the municipality's budget, the number of staff of only one auditor is not sufficient to effectively support the work of the Audit Unit. According to Administrative Instruction No. 23/2009 On Establishment and Operation of Internal Audit Units in the Public Sector, the municipality should have at least three audit staff. This unit planned to perform six audits for 2013 whereas it finalised only two audits. The audit covered activities of last two years (2012 and 2103). The areas in which audits were carried out are: Urbanism Directorate and Assets Management. The quality of reporting and contributions of IAU for 2013 were quite limited in providing the management an overview on the level of internal controls within the Municipality.

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### Issue 11 - IAU work focus and recommendations - High Priority

**Finding** Internal audit only addressed a limited proportion of the intended plan and has not included known risk such as in procurement, revenues from taxes and fees, subsidies and transfers and collection of account receivables. For actual work undertaken no action plan has been produced by management to address recommendations.

**Risk** Management are not receiving appropriate assurance from IA over the effectiveness of internal controls resulting in weaknesses not being identified and inefficient practices being continued resulting in potential financial loss to the Municipality

**Recommendation 12** The Mayor should work with IAU to develop a risk based plan that will provide assurance over all significant areas during 2014. Where recommendations are made these should be actively considered by management and an action plan developed to address agreed recommendations within a relevant timescale. Also, the mayor should consider increasing the number of staff at IAU.

**Issue 12 - Failure to establish the Audit Committee - High Priority**

**Finding** The Municipality did not establish the Audit Committee in order to facilitate implementation of audit recommendations.

**Risk** Lack of an Audit Committee reduces the level of challenge and support to the IAU, including the support for implementation of their recommendations.

**Recommendation 13** The Mayor should ensure that an Audit Committee is established applying good practices and secure that the Internal Audit carries out good quality work and in accordance with standards and good practices.



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

(extract from ISSAI 200)

### Form of opinion

147. The auditor should express **an unmodified opinion** if it is concluded that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework.

If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with the section on "Determining the type of modification to the auditor's opinion".

148. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor should discuss the matter with the management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the audit opinion.

### Modifications to the opinion in the auditor's report

151. The auditor should modify the opinion in the auditor's report if it is concluded that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or if the auditor was unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. Auditors may issue three types of modified opinions: a qualified opinion, an adverse opinion and a disclaimer of opinion.

Determining the type of modification to the auditor's opinion

152. The decision regarding which type of modified opinion is appropriate depends upon:

- The nature of the matter giving rise to the modification – that is, whether the financial statements are materially misstated or, in the event that it was impossible to obtain sufficient appropriate audit evidence, may be materially misstated; and
- The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

153. The auditor should express a **qualified opinion if**: (1) having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or (2) the auditor was unable to obtain sufficient appropriate audit evidence on which to base an opinion, but concludes that the effects on the financial statements of any undetected misstatements could be material but not pervasive.

154. The auditor should express an **adverse opinion if**, having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

155. The auditor should **disclaim an opinion if**, having been unable to obtain sufficient appropriate

audit evidence on which to base the opinion, the auditor concludes that the effects on the financial statements of any undetected misstatements could be both material and pervasive. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the audit scope that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 1705<sup>19</sup> provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

Emphasis of Matter paragraphs and Other Matters paragraphs in the auditor's report

157. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, but there is sufficient appropriate evidence that the matter is not materially misstated in the financial statements, the auditor should include an Emphasis of Matter paragraph in the auditor's report. Emphasis of Matter paragraphs should only refer to information presented or disclosed in the financial statements.

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158. An Emphasis of Matter paragraph should:

- be included immediately after the opinion;
- use the Heading “Emphasis of Matter” or another appropriate heading;
- include a clear reference to the matter being emphasised and indicate where the relevant disclosures that fully describe the matter can be found in the financial statements; and
- indicate that the auditor’s opinion is not modified in respect of the matter emphasised.

159. If the auditor considers it necessary to communicate a matter, other than those that are presented or disclosed in the financial statements, which, in the auditor’s judgement, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report, and provided this is not prohibited by law or regulation, this should be done in a paragraph with the heading “Other Matter,” or another appropriate heading. This paragraph should appear immediately after the opinion and any Emphasis of Matter paragraph.

## Annex II: Prior year recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
1. Annual Financial Statements	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.		Yes	
2. Prior Year Recommendations	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.			No
3. Revenues	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.	Yes		
4. Reporting Requirement	The Mayor should place priority on developing self reporting and other reports as required in 2013.			No
5. Revenues (including own source revenues)	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.		Yes	

6. Revenues (including own source revenues)	<p>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.</p> <p>Also, the controls on construction licenses tax payments must be strengthened, so that they are paid in accordance with the terms established by the Municipality.</p>			No
7. Revenues (including own source revenues)	The Mayor should ensure that revenues are recorded in the appropriate codes, through the guidance of staff and the establishment of appropriate controls.	Yes		
8. Expenditures	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.	Yes		
9. Expenditures	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.	Yes		
10. Expenditures	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.			No
11. Remunerations (Wages and Salaries)	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.	Yes		

12. Subsidies and Transfers	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.			No
13.Assets management	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.			No
14. Internal Audit System	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.			No