



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

Document No: 22.4.1-2014-08

**AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE
MUNICIPALITY OF ISTOG
FOR THE YEAR ENDED 31 DECEMBER 2014**

Prishtina, June 2015

The Office of the Auditor General undertakes both Regularity and Performance Audits. The Acting Auditor General is the head of the Office of the Auditor General which employs around 145 staff. The Auditor General and the Office of the Auditor General 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 Office of the Auditor General directly promote accountability as they provide a base for holding managers’ of individual budget organisations to account.

The Acting 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), Faik Thaqi, Elvir Krasniqi (team members).

TABLE OF CONTENTS

Executive Summary	4
1 Audit Scope and Methodology	7
2 Annual Financial Statements and other External Reporting Obligations	9
3 Prior Year Recommendations	12
4 Governance	13
Annex I: Explanation of the different types of opinion applied by the OAG	24
Annex II: Prior Year Recommendations	27

Executive Summary

Introduction

This report summarises the key findings from our audit of the 2014 Annual Financial Statements of Municipality of Istog, which determine the Opinion given by the Auditor General. I would like to thank the Mayor and his team for their assistance during the audit process.

The examination of the 2014 annual financial statements was undertaken in accordance with the internationally recognised Public Sector auditing standards (ISSAIs). 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 22.10.2014.

Our audit focus has been on:



The level of work undertaken by the Office of the Auditor General to complete the 2014 audit is a direct reflection of the quality of the internal controls implemented by management.

Opinion

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

The Auditor General’s opinion is:

In our opinion the Annual Financial Statements *present a true and fair view* in all material aspects, except for the following issues:

The Municipality made a wrong classification of expenditures, thus paying €227,778 for goods and services as well as subsidies and transfers from the Capital Investments category; and

The Municipality made an irregular payment of €43,104 for a project that was not delivered during 2014.

Emphasis of Matter

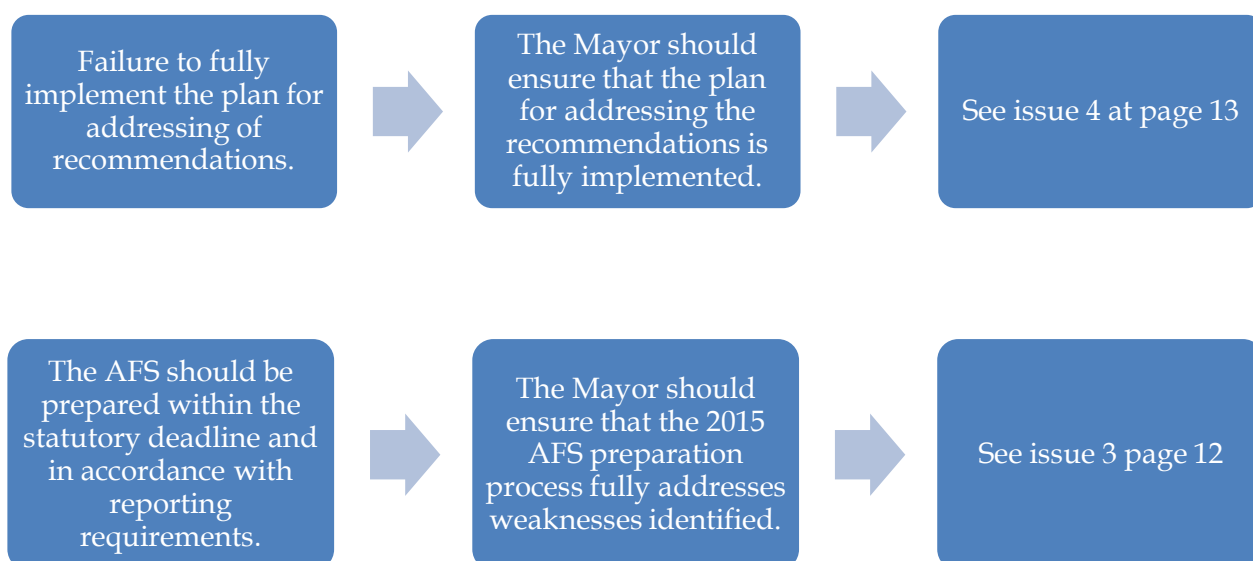
We would like to highlight the fact that the value of assets recorded in the AFS was incomplete because 1,565 land plots were not recorded in KFMIS and progress payments of €345,216 paid as on-going investments were recorded as final projects.

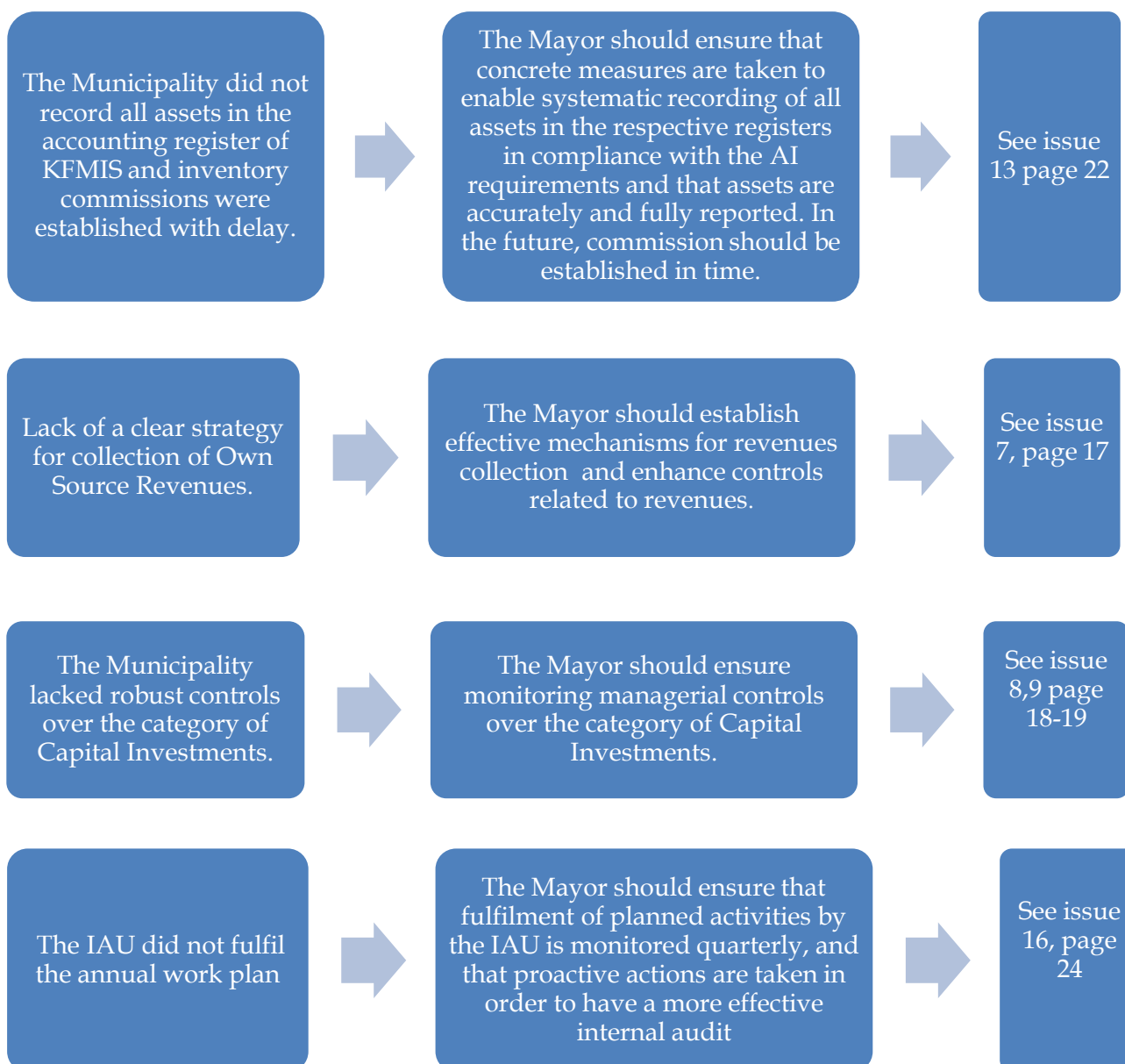
(ISSAI 200/1705: Qualified Opinion with Emphasis of Matter).

Overall Conclusion

The Municipality’s Management designed the internal control system at a satisfactory level. However, the system needs to be monitored to ensure that internal controls are continuously operating.

Our key conclusions and recommendations are:





Management response – audit 2014

The Management has agreed with all audit findings and committed themselves to address our recommendations

We take it for granted that the Mayor:

- Table the Audit Report for discussion in the Local Assembly; and
- During January/February 2016 initiate a discussion in the Local Assembly regarding the implementation of the Action Plan on audit recommendations, before AFS 2015 are submitted to Ministry of Finance.

1 Audit Scope and Methodology

It is the responsibility of Istog Municipality's Management to prepare Annual Financial Statements (AFS) 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 AFS and other financial records and expression of:

- 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. Management activity also determines the focus of our compliance audit and good governance audit which do not directly impact on the opinion.

Our audit approach to governance is focused on evaluating the actions taken by management to secure effective financial management and control and the results of this action in efficiently delivering high quality operational outputs. We consider whether controls are well designed, have been implemented as planned and operate effectively. This requires an assessment of structures, processes and accountability lines introduced by management including the role undertaken by Internal Audit and Audit Committees as well as inbuilt system controls.

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 how the Management have addressed recommendations made in the report on 2013 may be found in Annex II.

For completeness we have included issues identified at the interim audit where they remain relevant. At the interim audit stage we provide advice to enable relevant action to be taken in advance of the AFS production and final audit.

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.

Findings considered low priority will be reported separately to finance staff.

Our procedures included a review of the internal controls and accounting systems and associated substantive testing 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 and other External Reporting Obligations

Introduction

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 Mayor and the 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. The declaration is intended to provide assurance to the Government that all relevant information has been provided to ensure that a comprehensive audit can be undertaken.

Overall Conclusion

Our overall conclusion relating to AFS is that some errors have been identified such as: classification in inadequate codes, irregular payments and assets disclosure. External reporting requirements were fulfilled.

2.1 Audit Opinion

In our opinion the Annual Financial Statements *present a true and fair view* in all material aspects, except for the following issues:

The Municipality made a wrong classification of expenditures, thus paying €227,778 for goods and services as well as subsidies and transfers from the Capital Investments category; and

The Municipality made an irregular payment of €43,104 for a project that was not delivered during 2014.

Emphasis of Matter

We would like to highlight the fact that the value of assets recorded in the AFS was incomplete because 1,565 land plots were not recorded in KFMIS and progress payments of €345,216 paid as on-going investments were recorded as final projects.

(ISSAI 200/1705: Qualified Opinion with Emphasis of Matter).

2.2 Significant Risks to the Annual Financial Statements

Description

Our Audit Planning Memorandum dated 22.10.2014 identified two significant risks to the AFS related to the assets completeness and Third Party Payments. The risks of material misstatement that we have identified have occurred because the Management did not take actions to address risks presented.

Identified Risk

Issue 1 - Failure to record Third Party Payments.

Audit response and Findings

We reviewed the financing of projects and payments made by external donors to the Municipality. We found that the management does not have a database about projects financed by external donors. As a result, no values were presented in the AFS as third party payments.

Recommendation 1 High Priority – The Mayor should ensure that complete records are kept for projects financed by external donors in order to present them as third party payments in the AFS.

Identified Risk

Issue 2 – Failure to record all assets owned by the Municipality will result in material understatement of asset values in the AFS.

Audit Response and Findings

There was no significant progress on asset recording. We have assessed the controls implemented by Management to prove the completeness of asset records. 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. Therefore, assets values recorded in the AFS were incomplete because 1,565 land plots were not recorded in KFMIS and progress payments of €345,216 paid as on-going investments were recorded as final projects. Emphasis of Matter has been applied to the 2013 AFS for the same shortcomings.

Recommendation 2 High Priority - The Mayor should analyse the reasons for the 2013 Emphasis of Matter and identify the action required to address these controls weaknesses in order to enable a true and fair presentation of Assets in the 2015 AFS.

2.3 Compliance with AFS and other reporting requirements

Description

The Municipality is required to comply with a specified reporting framework and other reporting requirements. Municipality fulfilled the following reporting requirements:

- Compliance with the Financial Regulation no. 03/2013;
- Quarterly reports, including Nine-Month Financial Statements on time;
- Requirements of LPFMA no.03/L-048;
- Operational (performance) reports; and
- Draft and final procurement plan on time; and

The Municipality prepared the AFS with a delay of nine days. They were prepared on 09.02.2015 and submitted to the MoF.

A number of adjustments were required to the draft AFS and we made a number of other suggestions for improvements. AFS were therefore adjusted. However, despite adjustments, shortcomings are described as follows:

Issue 3 – AFS Preparation Process – High Priority

Finding Istog Municipality misstated expenditures of capital investments in the AFS, thus paying €227,778 for goods and services as well as subsidies and transfers from the Capital Investments category;

The Municipality made an irregular payment of €43,104 for a project that was not delivered fully during 2014 (for more, refer to Issue 9); and

In Note 31 - Summary of non-financial capital assets - the net total amount of assets over €1,000 presented in the AFS was €12,262,984. This did not include municipal properties and, although being on-going investments, some capital projects were recorded as completed. For more information, refer to Chapter 2.2 of this report.

Risk Inaccurate presentation of AFS and errors identified in the recorded amounts lead to misunderstanding of municipality's financial position, and may potentially have negative impact on the accurateness of future budget requests.

Recommendation 3 The Mayor should ensure that the plan for drafting of AFS for 2015 formally addresses all requirements related to information quality. The declaration made by the Mayor and the Chief Financial Officer should not be submitted unless all necessary controls on the draft AFS are made.

3 Prior Year Recommendations

Overall Conclusion

The Municipality prepared a plan for addressing prior year recommendations. Nevertheless, only a proportion of the prior year recommendations have been implemented.

Description

Our Audit Report on the 2013 AFS of Municipality of Istog resulted in 13 key recommendations. At the end of our 2014 audit, four recommendations have been fully addressed; five are partially addressed; and four have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II.

Issue 4 - Addressing Prior Year Audit Recommendations - High Priority

Finding Only a proportion of prior year recommendations have been implemented because the Municipality did not carry out an formal process to manage and monitor the way the AG's recommendations are implemented.

Risk The continued management weakness and other controls over key financial systems have resulted in the same problems as those in prior years, such as: incomplete presentation of assets, delays in improving controls related to revenue collection, payments made prior to completion of works, payments made from inadequate economic codes, etc.

Recommendation 4 The Mayor should ensure that a revised action plan clearly sets out a timetable for addressing the recommendations made by the AG with accountable staff members identified and with initial focus on those of greatest significance. The Mayor should systematically review implementation of this plan.

4 Governance

Overall Conclusion

Istog Municipality had not addressed material errors in the assets recorded in the AFS. Despite this, the overall quality of the AFS was good with only a small number of non-material errors identified. All reporting requirements have been met. Other external reporting obligations were fully met except for monthly reporting of liabilities. However, the municipality has actively address the 15% budget cut related to goods and services and last year external audit report was discussed in municipal assembly

Self-assessment -was initiated but not completed at the time during our audit, however we encourage that municipality apply a critical approach during self-assessment as a starting point to improve performance where appropriate

Risk- management – the municipality has not yet established formal and documented procedures for risk identification and management , which would mitigate exposure to risks associate with the achievement of Municipality’s objectives

We also found that controls over revenues planning process were not good and not analysed in a sustainable way either. Controls over a range of expenditure areas require further enhancement to prevent the Municipality from suffering financial loss, poor value for money and ineffective project management.

Issue 5 - Accountability Processes – High Priority

Finding Our review of management controls implemented in Municipality’s key financial system resulted in reporting weaknesses. The reporting to the Mayor is made when needed and Directors did not report in writing for their works and activities on a regular basis. We did not rely on high level controls at several economic categories such as: revenues, goods and services, subsidies and transfers, capital investments.

Risk Directors’ failure to regularly report in writing to the Mayor reduces the Management’s ability to effectively run the Municipality activities, to respond to financial challenges on a timely basis and to implement effective control over the budget.

Recommendation 5 The Mayor should ensure that review is carried out to determine the format of financial reporting to the senior management, which is required to support effective business management. This should be supported by a governance structure where senior management is informed on risks, the weaknesses of controls and actively manage them.

4.1 Budget Planning and Execution

Description

We have considered the sources of budgetary funds for Istog 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 ¹	2014 Outturn	2013 Outturn	2012 Outturn
Sources of Funds	7,789,708	8,738,017	8,176,752	8,339,097	7,855,664
Government Grant -Budget	6,844,708	7,555,922	7,420,977	7,406,811	6,988,068
Carried forward from previous year ² -	0	188,922	106,245	144,464	233,888
Own Source Revenues ³	945,000	945,000	606,985	683,436	608,049
Domestic Donations	0	30,090	24,465	48,789	24,909
External Donations	0	18,083	18,080	55,597	750

The final budget was by €948,309 higher than the initial budget. This was as a result of External and Domestic Donations of €48,173, revenues of €188,922 carried forward from the previous year, and increased Government Grant of €711,214 due to increase in salaries.

Istog Municipality used 94% of the final budget in 2014, a downfall of €162,184 compared to the previous year. A decreased budget execution incurred in the category of Own Source Revenues.

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
Spending of funds broken down by economic categories	7,789,708	8,738,017	8,176,752	8,339,097	7,855,664
Wages and Salaries	4,356,810	5,068,024	5,046,011	4,318,168	4,272,524
Goods and Services	709,200	720,791	629,647	864,385	1,019,243
Utilities	148,358	148,775	126,008	187,559	149,952
Subsidies and Transfers	214,750	285,328	168,359	359,903	322,123
Capital Investments	2,360,590	2,515,099	2,206,727	2,609,082	2,091,822

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

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

³ receipts used by the entity for financing its own budget.

Explanations for changes in budget categories are given below:

- Despite an increase in budget for capital expenditure only 88% of the budget was spent;
- The increase of €711,214 in the budget for Wages and Salaries and €11,591 for Goods and Services was as a result of revenues carried forward from prior year; and
- Budget execution in 2014 was at around 94%. Compared to 2013 (96%), there is decline.

Issue 6 - Payments based on court decisions- Medium Priority

Finding According to the suppliers' data, Istog Municipality spent €2,017 during 2014 following court decisions.

Risk Making unplanned payments increases the risk that planned projects will not be implemented and Municipality will not achieve objectives set.

Recommendation 6 The Mayor should ensure that invoices are paid in time and that the risk of payments being made through court decisions is avoided.

Table 3 Own Source Revenues collected – outturn against budget (in €)

Description	Initial Budget	Final Budget	2014 Receipts	2013 Receipts	2012 Receipts
Own source revenues	945,000	945,000	936,047	683,436	608,049

Own Source Revenues were collected at 99% of the 2014 budget, showing an increase of €252,608 or 37% compared to revenues in 2013. We noticed that there is an increasing trend of revenue collection by the Municipality.

4.2 Revenues (including own source revenues)

Description

Istog Municipality established controls over revenues collection and reporting. However, some processes need to be improved in order to support the accuracy and completeness. In the collection process we have identified the following issues:

Issue 7 - Revenues Collection - High Priority

Finding The Municipality has not developed a policy on collection of debt arrears of €1,019,763 from property tax, €97,471 from construction permits and €182,933 from business tax.

In addition, we identified that the Municipality did not adhere to the internal regulation by not organising leasing procedures through public auction.

Risk Failure to develop a Own Source Revenues collection policy may lead to revenues already billed not being collected thus reducing the possibility of projects funded by own source revenues to be delivered. Leasing property without organising a public auction leads to the risk of making the wrong choice, limits the market supply and impairs the principle for free competition and equal treatment of all parties interested.

Recommendation 7 The Mayor should ensure that a strategy is put in place specifying all measures and appropriate mechanisms for collection of previous years' debt arrears. In addition, the Mayor should ensure organising leasing procedures through public auction of municipal property.

4.3 Expenditures

4.3.1 Procurement

Description

In 2014, Istog Municipality spent €2,962,561 for Capital Investments and Goods and Services categories. We have tested €1,274,920 or 43%, and 16 samples of procurement activities of €856,387.

Our tests have revealed the following weaknesses:

Issue 8 – Systematic Weaknesses in Procurement – High Priority

Finding

The Municipality has extended the deadlines of framework contracts in contradiction to Article 38.2 of the LPP, which stipulates that public framework contracts cannot be extended or renewed. Cases where framework contracts have been extended are for:

- supply of food and hygiene items;
- repair of local roads;
- Supply with consumable stationery for institutions of Istog Municipality; and
- fuel supply.

In the project “Insulation and facade painting of Avni Rrustemi Elementary School”, the Municipality awarded the contract to an ineligible Economic Operator (EO). This EO lacked proof of ownership on equipments, which was one of the criteria required in the Tender Dossier.

We identified 15 cases (payments) where the Municipality had misclassified expenses of €227,778. Payments were carried out from the category of Capital Investments, whilst expenses were for subsidies and goods and services.

Risk

Extension of framework contracts is not only in contradiction with the Law on Procurement, but it also hampers free competition. As a result, the Municipality may suffer higher expenses than in the market conditions. Awarding contracts to ineligible EOs leads to the risk that works are not executed of the expected quality.

Misclassification of expenses leads to overstatement of capital expenses and understatement at the Subsidies and Transfers category.

Recommendation 8 The Mayor should ensure that:

Frameworks contracts are not extended and that the criteria in the Tender Dossier are adhered to in order to have contracts awarded only to eligible EOs;

Furthermore processed expenditures should be classified and recorded under the adequate codes.

Issue 9 – Payment made for not executed works – High priority

Finding For the construction of irrigation channel in Goga, the Municipality signed a contract of €100,000. To implement this project, the Municipality paid €99,992 for 1,750 meters of dug channels. The Municipality made payments based on the reports from the Supervisory Body and Technical Acceptance Commission, which accepted completion of works. In February 2015 we examined the field work and found that only 1062 meters of channel of an equivalent value of €56,888 were dug. We informed the Mayor about the identified shortcomings in project implementation and he took measures to eliminate the abovementioned shortcomings. Thus, as of 20.03.2015, works were completed.

Risk Shortcomings were noticed in contract management. Such payments do not comply with financial rules on spending of public money and payments made in advance to completion increases the risks that projects will not be delivered or even result in additional costs. A similar case of payment made in advance to completion of works was reported in our 2013 audit report as well.

Recommendation 9 The Mayor should ensure that the channel in Goga case is revisited and analyse the reasons behind the process failures. He should enhance monitoring controls in order to prevent such situation from repeating in the future and undertake additional measures when needed. The commission should be put to account and applicable administrative measures should be taken.

4.3.2 Other expenditures

Issue 10 – Non-systematic weaknesses – High Priority

Finding We tested payments of €39,702 and found that the Municipality had invested in the electricity distribution network of several villages. Investments in the electricity network are a responsibility of the private company for electricity distribution (KEDS) rather than the Municipality's.

Risk Investing in private property is not only beyond Municipality's powers but it also leads to the risk that the investment in electricity distribution network will not be recorded as a Municipality's asset.

Recommendation 10 The Mayor should ensure that no investments are made in private assets and exercise his powers according to the Law on Local Governance

Issue 11 – Funds transferred without approval of MoF – High Priority

Finding We tested payments made for capital projects and found that four payments of €66,782 intended funds were not used for projects they were allocated for in the Law on Budget 2014. These funds were used to finance other planned projects. The transfer of these funds was not in compliance with Financial Rule no.01/2013 on Spending of Public Money, which stipulates that the request should be sent to MoF.

Risk Transferring funds in contradiction to Treasury rules increases the risk for public funds being spent outside the established rules and planned projects not being implemented.

Recommendation 11 The Mayor should ensure to execute projects in line with planned budget and in cases of transferring funds between projects, the applicable legal framework should be applied.

4.3.3 Remunerations (Wages and Salaries)

Description

The final budget for Wages and Salaries category was €5,068,024, whilst the expenditures for this category were €5,046,011 or 99%.

Wages and Salaries are paid through a centralised system (payroll). Controls operated locally by Municipality relate to a) control of payments on monthly basis by signing payroll, b) verification of possible changes that may occur through forms, c) review the budget for this category and reconciliation with Treasury.

We tested 54 samples in this category and reviewed the compliance of employment contracts with the payroll list. In addition, we reviewed whether the positions of officials and their multipliers are in accordance with the form of the payroll system. We identified the following issues:

In January 2015, Istog Municipality had a lack of funds of €4,281 in two sub-programs of the Directorate of Education, due to maternity leave. On 16.02.2015, the Municipality made a request for transfer of funds from the secondary education program to the elementary program and MoF approved Municipality's request on 23.02.2015.

Issue 12 - Job positions in the contracts were not in compliance with the payroll - Medium Priority

Finding Istog Municipality has 16 Heads of Personnel in its payroll since 2010. This was because directors of municipal directorates had decided in 2010 to increase multipliers of 16 employees from 7.5 to 9.5. In fact, the Municipality has only one employment contract for one Head of Personnel, whilst the other employees hold employment contracts for Certifying Officer, Approving Officers, Heads of Sectors, Coordinator for Gender Equality etc.

The personnel office has not managed yet to organise personnel files in the electronic form, as required under the Regulation 03/2011 on Personnel Files. Moreover, we tested six samples in the Health Directorate and identified that personnel files were missing the annual appraisals for 2014.

Risk Increasing multipliers for 16 employees generates dissatisfaction of employees in the municipal administration. Moreover, increase of multipliers is not under municipal directorates power and indicates that the Mayor's responsibilities in making decisions have been overlooked (Article 13 of the Law on Local Governance stipulates that only the Mayor has the right to make certain decisions or orders).

Recommendation 12 The Mayor should reconsider the issue related to increase of multipliers and ensure that those 16 Heads of Personnel no longer exist in the payroll. In addition should be ensured that personnel files are maintained in electronic form.

4.3.4 Subsidies and Transfers

Description

In 2014, Istog Municipality planned the budget of €285,328, whilst spent €168,359.

Istog Municipality addressed prior year recommendation by issuing internal regulation on granting of subsidies and having it approved by the Municipal Assembly. This regulation was approved on 30.06.2014.

Recommendations

We have not identified any significant issues to address.

4.4 Assets and Liabilities

4.4.1 Capital and Non Capital Assets

Description

We noticed that the Municipality has carried on with recording assets in KFMIS and progress has been shown compared to the previous year. In the 2014 AFS the Municipality presented the net assets value of €12,262,984, whilst in 2013 it was €10,556,261 i.e. a net increase of €1,706,723.

The Municipality's activity of assets recording is of significance importance as it managed to record €2,188,234 in the accounting register only in 2014. However, a lot more work is needed until the establishment of the final register.

We tested Municipality's leased properties (lands) of 90 hectares, which were not recorded in the Accounting Register.

Issue 13 - Incomplete recording of assets, and Commission for Recording and Stocktaking did not prepare reports - High Priority

Finding The Municipality managed to identify 1,540 municipal parcels owned by the Municipality, but it has not managed to record them in the Accounting Register yet because the properties do not have a financial value.

According to the Administrative Instruction, the Municipality established the Assets Stocktaking Commission and Assets Evaluation Commission at the end of the year. The Assets Stocktaking Commission was established on 09.01.2015, but it did not produce any report on assets balance.

Risk Incomplete recording of all assets owned by the Municipality increases the risk that assets are understated and results in inaccurate presentation of assets value. Delayed establishment of commissions leads to the risk that the organisation may suffer the loss, misuse, and unauthorised use of assets.

Recommendation 13 The Mayor should ensure that concrete measures are taken to enable systematic recording of all assets in the respective registers in compliance with the AI requirements and that assets are accurately and fully reported. In addition, he should establish the commissions at the end of each year and ensure that assets registers are updated with recording results.

4.4.2 Handling of Receivables

Description

Istog Municipality did not take concrete measures to reduce accounts receivable. These receivables result from property tax, construction permits, business tax (businesses obligations are not paid off yet, despite the removal of business tax), lease of buildings and of municipal property etc.

Issue 14 – Handling of Accounts Receivable - High Priority

Finding The accounts receivables for 2014 were €1,323,186. Compared to the previous year (€1,186,000), they increased by €137,186 or approximately 11%.

Risk Due to Municipality's inefficient collection of Own Source Revenues, receivables have increased from year to year, and this reduces Municipality's ability to finance projects.

Recommendation 14 The Mayor should ensure that strategic plan for collection of accounts receivables is produced, by defining clear measures, timeframes and persons responsible for implementation of the plan.

4.4.3 Handling of Debts

Description

The outstanding liabilities of Istog Municipality were €142,000 at the end of 2014, whilst previous year's liabilities were €48,179 i.e. the outstanding liabilities have increased by €93,821 or 66%.

Issue 15 – Failure to report outstanding liabilities on monthly basis to the Treasury - Medium Priority

Finding Istog Municipality did not report monthly liabilities to Ministry of Finance/Treasury in accordance with Article 5 of Rule 02/2013.

Furthermore, the outstanding liabilities have increased by €93,821 at the end of 2014.

Risk Failure to report outstanding liabilities to the Treasury besides being in contradiction with the Article 5 of the Treasury Rule 02/2013 on Reporting of Liabilities, also leads to the risk for inaccurate presentation of Municipality's liabilities in the AFS and makes budget planning for the following year difficult.

Recommendation 15 The Mayor should ensure that outstanding liabilities are reported to Treasury on monthly basis and undertake measures in order that invoices are paid within the legal timeframe.

4.5 Internal Audit System

Description

The Internal Audit Unit (IAU) planned five (5) audit reports in the annual audit plan, whilst two were completed during 2014. We consider the audit reports to be of an average level, but for our auditing purposes we have not relied on those reports.

The Municipality has established an Internal Audit Committee in October 2014.

Issue 16 – IAU failed to fulfil the annual work plan - Medium Priority

Finding

The IAU was not even close to fulfilling the annual work plan. This unit had produced two audit reports on the procurement area. The audit in the Procurement Office focused on 2013, whilst the audit in the Public Services Directorate focused on 2013 and 2014. The input provided by the internal audit did not help the Management to have an understanding of the actions and effectiveness of controls and take corrective measures therefrom.

The IAU does not have the statute of internal audit which defines the rights and responsibilities of the senior management and internal audit.

The Management (audited units) do not draft a plan for addressing audit recommendations.

These findings suggest lack of attention to provide maximum benefits that an internal audit system can provide for the Municipality.

Risk

Due to insufficient work by the internal audit, the Management is unable to have clear view on the functioning of internal controls. As a result, identified weaknesses have not been corrected and continue to repeat. An uncompleted program of IAU diminishes the assurance that is provided to Management regarding the functioning of financial systems. This may result in undetected weaknesses and inefficient practices being repeated, thus leading the Municipality to financial losses.

Recommendation 16 The Mayor should ensure that fulfilment of planned activities by the IAU is monitored quarterly, and that proactive actions are taken in order to have a more effective by improving internal control system. IAU should produce and sign the Internal Audit Statute.

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 1705¹⁹ provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

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

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

158. An Emphasis of Matter paragraph should:

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

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

Annex II: Prior Year Recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
1. Financial statements	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.		Partially	
2. Assets	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.			Unaddressed
3. External reporting	The Mayor should ensure that all external reporting obligations are met with a good quality and within the specified timeframes.		Partially	
4. Addressing of recommendations	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).	Addressed		

5. Governance and control	The Mayor should ensure that an appropriate governance structure is implemented, through which the senior management is informed on die control shortcomings and manages them actively. This process should be supported by submitting self-assessment report required by die MoF.		Partially	
6. Own Source Revenues-property tax	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.			Unaddressed
7. Revenues-construction permits	The Mayor should review procedures for issuing construction licenses and ensure that construction license fees are paid before the license is issued	Addressed		
8. Procurement	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.		Partially	
9. Payments for unfinished works	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.			Unaddressed
10. Subsidies	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.	Addressed		
11. Accounts Receivable	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.		Partially	

12. Internal Audit System	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.			Unaddressed
13. Internal Audit Committee	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.	Addressed		