



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

Document No: 22.4.1-2015-08

**AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE
MUNICIPALITY OF ISTOG
FOR THE YEAR ENDED 31 DECEMBER 2015**

Prishtina june 2016

The Auditor General of the Republic of Kosovo is the highest institution of economic and financial control which, according to the Constitution and domestic laws, enjoys functional, financial and operational independence. The Office of the Auditor General undertakes regularity and performance audits and is accountable to the Assembly of Kosovo.

Our Mission is to contribute to sound financial management in public administration. We perform audits in line with internationally recognized public sector auditing standards and good European practices.

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. We are thus building confidence in the spending of public funds and playing an active role in securing taxpayers' and other stakeholders' interests in enhancing public accountability.

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 Lavdim Maxhuni, Team Leader, and Edon Kabashi Team Member.

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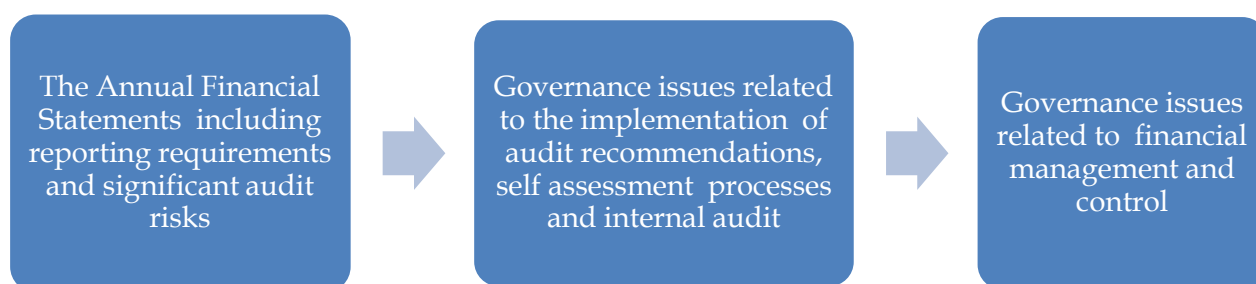
Executive Summary

Introduction

This report summarises the key findings from our audit of the 2015 Annual Financial Statements of the Municipality of Istog, which determine the Opinion given by the Auditor General. We would like to thank the Mayor and his team for their assistance during the audit process.

The examination of the 2015 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 02.10.2015.

Our audit focus has been on:



(For more details see Annex I of this report)

The level of work undertaken by the Office of the Auditor General to complete the 2015 audit is a direct reflection of the quality of the internal controls implemented by management.

Opinion

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

The Auditor General's opinion is:

“Unmodified Opinion with Emphasis of Matter”, because municipal assets were understated as a result of failure to record 1540 municipal parcels in the accounting register. In addition, accounts receivable were understated for €183,129. Third party payments of €490,000 were not recorded in KFMIS.

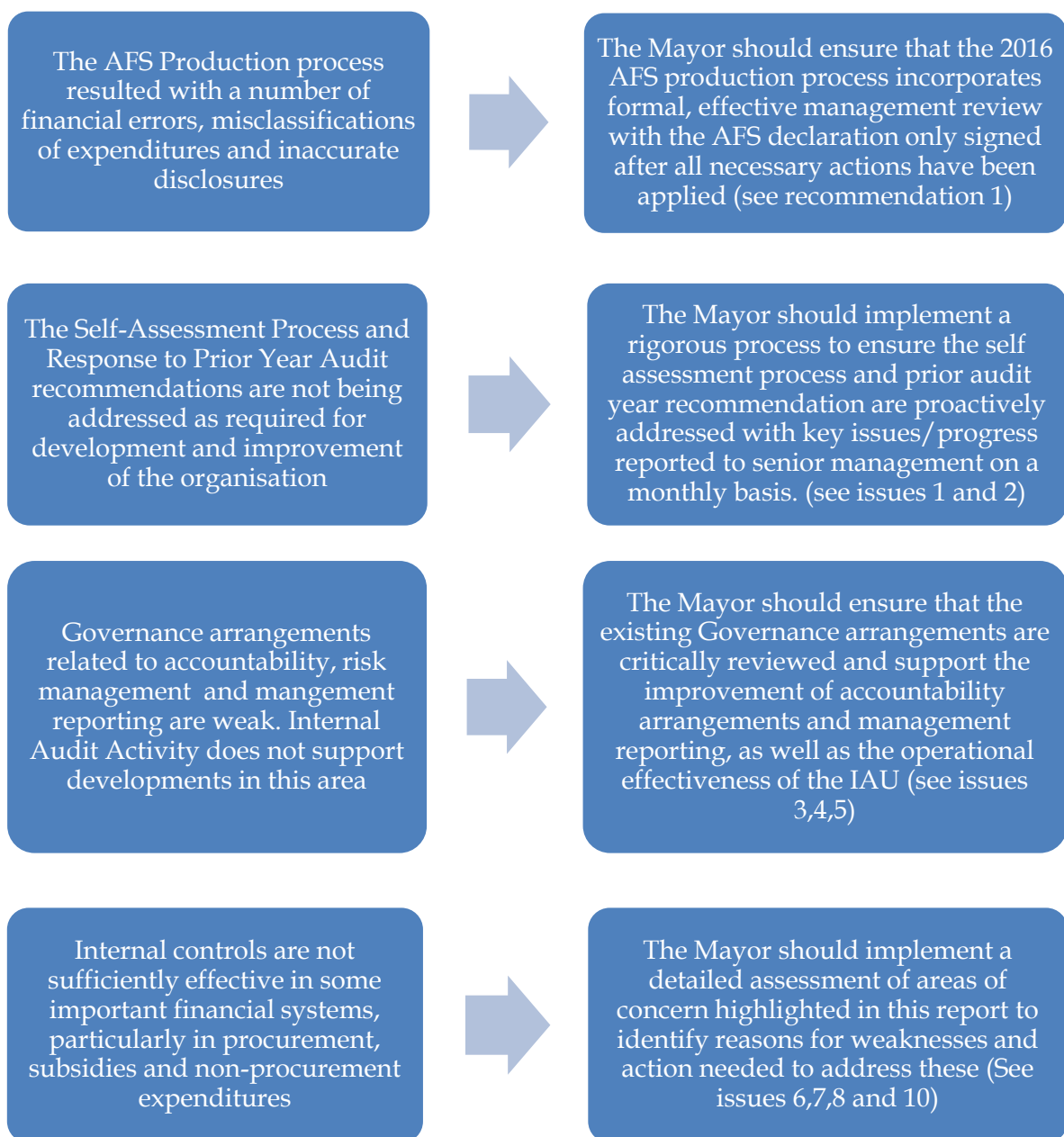
A full wording of the opinion is detailed in Section 1.2 of this report.

Overall Conclusion

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

Currently the internal control system does not provide assurance that operational and financial activities of the municipality are carried out effectively, and as such, there is a need for enhanced oversight and improvement in some areas.

Our key conclusions and recommendations are:



Leasing of municipal property
(arable land) was not done
through public actions



The Mayor should ensure organising
of public auctions when leasing
municipal properties, so that there is
an open and transparent process (see
issue 12)

Management response - audit 2015

The Mayor has taken into consideration and agreed on the audit findings and conclusions in this report and committed to address the recommendations given.

We take it for granted that the Mayor:

- Will discuss the audit report in the Municipal Assembly; and
- By the end of January 2017, will also discuss the progress made on the implementation of the Action Plan on audit recommendations in the Municipal Assembly, before the AFS 2016 are submitted to the Ministry of Finance.

1 Annual Financial Statements and other External Reporting Obligations

1.1 Introduction

Our review of the Annual Financial Statements (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.

1.2 Audit Opinion

TO: MUNICIPALITY OF ISTOG

UNMODIFIED OPINION WITH EMPHASIS OF MATTER

We have audited the Annual Financial Statements of the Municipality of Istog for the year ended on 31.12.2015 which comprise of the Statement of Receipts and Payments in Cash, the Statement of Comparison of Budget and Actual Amounts, Explanatory Notes in the AFS and Disclosures.

In our opinion, the Annual Financial Statements present a true and fair view in all material aspects of receipts, payments and executed budget of the Municipality of Istog for the year ended on 31.12.2015 in compliance with International Public Sector Accounting Standards (Cash Based Accounting), Law no.03/L-048 on Public Finance Management and Accountability (as amended and supplemented), and Financial Rule no.03/2013 on the AFS of Budget Organisations issued by the Ministry of Finance.

Basis of Opinion

We conducted an audit in accordance with International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Annual Financial Statements section of our report. We are independent of the municipality in accordance with the ethical requirements that are relevant to our audit of the Annual Financial Statements of budget organisations in Kosovo and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the obtained audit evidence is sufficient and appropriate to provide a basis for the opinion.

Emphasis of Matter

We draw your attention to the fact that the Fixed Assets Register does not confirm the complete situation of assets because registration was not completed yet. There were identified 1540 parcels that had not been recorded in the accounting register.

Moreover, accounts receivable were understated for €183,120 because they were not included in the AFS.

The Municipality presented third party payments of €490,000 in the AFS as direct payments that had not been recorded in KFMIS. Our opinion has not been modified in respect of these issues.

Responsibility of Management and Those Charged with Governance for the Annual Financial Statements

Management of the municipality is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards – Financial Reporting under the Modified Cash basis of Accounting and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. This includes the application of Law number 03/L-048 on Public Finance Management and Accountability as amended and supplemented.

Those charged with governance such as: the Mayor, Directors, and Financial Officers are responsible for overseeing the municipality's financial reporting process.

Auditor's Responsibility for the Audit of the Annual Financial Statements

Our responsibility is to express an opinion on the Annual Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Our objectives are to obtain reasonable assurance about whether the Annual Financial Statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control

relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Annual Financial Statements

1.3 Significant Audit Risks to the AFS

Description

Our Audit Planning Memorandum dated 02.10.2015 identified two risks that relate to misclassification of expenditures and incorrect recording of assets. These are risks of material misstatement which can result in modification of the opinion or emphasis of matter.

The risk of non-recording of municipal assets has occurred as the 1,540 municipal properties were not recorded in the accounting register.

The risk of misclassification of expenditures has occurred as the municipality during the year had paid the amount of €60,302 out of the Category of Capital Investments through the donor "Caritas Kosova" for good and services.

1.4 Compliance with AFS and other reporting requirements

The Municipality is required to comply with a specified reporting framework and other reporting requirements. We considered:

- Compliance with FR no. 03/2013;
- Requirements of LPFMA No.03/L-048, as supplemented and amended;
- Compliance with budget requests;
- Quarterly reports to the Municipal Assembly;
- Procurement plan and reporting on progress of capital investments with value over €10,000; and
- Nine-month financial statements.

The Municipality had handled the abovementioned requirements and is in line with the reporting framework.

In terms of quality of information, the AFS contain some errors and lack information, which is presented below:

- In the Article 12 - Statement of Receipts and Payments in cash - second column - Note 4 - payments from third parties, the municipality had presented the amount of €490,000 which were not recorded in the Treasury system as direct payments;
- In the Article 13 - Budget Execution Report – Entry of cash in the Treasury account - in the column initial budget – Note 17 Donations, the municipality had presented incorrectly the amount of €6,000 while it should have been €0;
- In the Article 13 - Budget Execution Report – Entry of cash in the Treasury account - in the column initial budget – Note 17 Donations, the municipality had presented the amount of €39,000, while according to the Free Balance data it should have been €33,264, i.e. with a difference of €6,264;
- The Municipality had misclassified expenditures, where out of the category of Capital Investments had paid the amount of €60,320 for salaries and wages for workers engaged in MFMC, based on the agreement entered into with “Caritas Kosovo” for the delivery of services foreseen in the Project for Home Healthcare and Ambulatory Services;
- It is worth explaining that the amount of €60,320 was approved in the budget tables of 2015 Budget for capital investments, but the projects presented in the tables do not meet the criteria for being regarded as capital projects and errors relate to initial planning by the municipality and inadequate approvals by MoF.
- In Note 32, summary of stocks at the end of the period, the municipality had presented only stocks of the Administration in the amount €5,000, while those of Health and Education were not presented;
- In Note 31, summary of non-capital assets with value under €1,000 with a lifespan of more than a year, the municipality had presented only purchases made during 2015 in the amount of €20,000. According to the e-assets they should have been €97,318; and
- In Note 34, receivables were understated by €183,120.

1.5 Recommendations

Recommendation 1 The Mayor should ensure that effective processes are in place to confirm that the 2016 AFS production plan formally addresses all audit issues raised, including complete recording of all assets. This should also include the review of the draft AFS by the management, with a special focus on areas of high risk/or areas where errors have been identified.

2 Governance

2.1 Introduction

Effective governance arrangements are fundamental to municipality's successfully managing the challenges it faces and ensuring that service delivery is optimised for the benefit of taxpayers and service users.

A key tool supporting effective Governance is the implementation of audit recommendations as this demonstrates that management are seeking to develop existing processes and controls. Similarly, the self-assessment checklist completed by all Budget Organisations provides a framework for developing enhanced Governance arrangements. It is important that the answers provided by an individual budget organisation are supported by appropriate evidence.

The remainder of our review of governance arrangements reflects a consideration of:

- areas of Governance Arrangements where significant improvements are required and where we believe that our recommendations can generate positive improvements, including consideration of the Internal Audit Unit; and
- areas of financial management and control identified through our audit work including specific work directed at compliance issues in key income and expenditure systems (these areas are considered in section 3 of this report).

2.2 Overall Governance Conclusion

There is more room for improvement in terms of governance, particularly related to risk management, quality of management reporting and the internal audit system. The self-assessment checklist completed by the municipality only partially recognises this situation.

2.3 Prior Year Recommendations

Our Audit Report on the 2014 AFS of municipality resulted in 16 key recommendations. The Municipality had prepared an Action Plan stating how all recommendations will be addressed.

At the end of our 2015 audit, three recommendations have been fully addressed; seven are in the process of implementation; and six have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II.

The audit report on 2014 AFS was discussed in the Municipal Assembly on 09.09.2015, which contributes to enhancement of transparency and a critical review of municipality's activities.

Issue 1 - Addressing Prior Year Audit Recommendations - High Priority

Finding Only a proportion of prior year recommendations have been implemented because the municipality has not implemented any formal process to manage and monitor the way that the AG's recommendations are implemented. Therefore, in this audit report we have raised issues again that relate to improvements in certain areas.

Risk The continued weakness of management and other controls in key financial systems have resulted in:

- Payments from inadequate economic codes;
- Failure to report outstanding liabilities in line with legal requirements; and
- Failure to organise auctions when leasing arable lands.

Recommendation 2 The Mayor should strengthen control measures and responsibilities towards officials who are responsible for complete implementation of recommendations, so that the actions foreseen under the Action Plan are implemented, particularly in the areas identified with the greatest degree of risk and within the limits set.

2.4 Self-Assessment Checklist

The Ministry of Finance (MoF) has produced a detailed self-assessment checklist for Budget Organisations to support effective governance arrangements. We have tested the quality of self-assessments submitted to the MoF by the municipality, and have summarised our findings on the municipality. This is not intended to give a commentary on the quality of the whole self-assessment questionnaire submission but will provide a ‘snapshot’ across a number of key questions to support the Ministry of Finance in its attempts to increase the effectiveness of the process and the overall development of the FMC system.

Issue 2 – Self Assessment Checklist – High Priority

Finding As part of our audit we have considered several key issues of the self-assessment questionnaire relating to constituent components. From issues reviewed we found that:

1. Expected risk management procedures are not in place and this is considered in more detail in section 2.5.1;
2. The Municipality does not have a strategy for local economic development;
3. Links between the procurement plan and budget as well as the production of adequate reports on a timely basis are considered in place by the municipality;
4. The internal audit has not handled abovementioned issues. Furthermore, the actions taken to address issues identified from the 2015 self-assessment are limited, and this is handled in detail in Chapter 2.6;
5. The reporting form done to the Mayor is carried out as needed and no reporting is done in writing regularly by the Directors on their tasks and activities (for more see sub-chapter 2.5.2)

Risk Poor governance arrangements weaken strategic and operational processes and reduce the quality of services provided to citizens through inefficient and ineffective activities.

Recommendation 3 The Mayor should ensure that governance processes are accompanied by strategic plans, risk management, and implementation of procedures, in order to measure results against objectives. In addition, reporting and communication will improve management’s ability to respond to potential challenges on time.

2.5 Specific Governance Reviews

Our work on specific areas of governance arrangements is based on our audit planning, by taking into account the context within which the municipality operates and the challenges that it faces.

2.5.1 Risk Assessment

All Budget Organisations are expected to implement risk assessment. Guidance set out requires the risk register to be complete in order to support effective operational and strategic management of the municipality.

Issue 3 – Failure to implement Risk Management Requirements - High Priority

Finding The Self-Assessment questionnaire completed by the municipality has proved that the municipality has not established yet formal identification procedures and risk management at the level of organisation that would diminish the exposure to risk related to the achievement of objectives established. This reflects lack of accountability to the senior management on managing of risks register and lack of knowledge within departments about their roles on providing support in the risks management process. For effective risk management are needed clear actions that have to be implemented for all significant risks that affect the organisation.

Risk Due to lack of a formal documented process of risks in the organisation will be reduced the ability of management to react timely against potential risks and to reduce the risks to an accepted level.

Recommendation 4 The Mayor should ensure establishment of formal procedures to manage risks in the organisation, so that necessary actions are determined and undertaken should they occur, and to monitor them systematically. The first step towards this is drafting of the risks registry.

2.5.2 Management Reporting

Ranges of internal controls are applied by Management to ensure that financial systems and operational activities operate as intended. It is important that these include appropriate reporting to management to enable an effective and timely response to identified operational problems.

Issue 4 - Weaknesses in Management Controls - High Priority

Finding	After the review of management controls applied to municipality's key financial system, we have noticed evident reporting weaknesses. The form of reporting is done to the Mayor as needed and there are no regular reporting done in writing by Directors on their works and activities. Due to above-mentioned reasons, we have not relied on functioning of senior level controls in some economic categories, such as revenues, goods and services, capital investments, subsidies and transfers.
Risk	Due to irregular reporting by departments to the Mayor is reduced management's ability to effectively run activities of the municipality, to respond to financial challenges at the right time, and to implement effective budgetary control.
Recommendation 5	The Mayor should ensure that a review is implemented to determine the format of financial reporting to senior management, which is required to support effective business management and to ensure that an appropriate solution is in place.

2.6 Internal Audit System

The Internal Audit Unit (IAU) operates with the Head of IAU. An effective IAU requires a comprehensive work programme that reflects financial and other risks, and provides sufficient assurance over the effectiveness of internal control. The impact of IAU output should be judged by the importance that management places on addressing recommendations and the support and challenge provided by an effective Audit Committee.

Issue 5 - Functioning of the IAU and Audit Committee - High Priority

Finding The Internal Audit Unit had planned four audits for 2015, out of which were implemented three.

Audits carried out covered the following areas: property tax (scope 2015), assets management (scope 2014 - January-June 2015), and the procurement process that covered 2014.

The Audit Committee had held four meetings. Based on minutes of meeting discussions were held on reports of IAU and OAG. Furthermore, the Committee needs to do a better quality work towards implementation of internal and external audit recommendations.

During the audit, we have noticed that the management had partially implemented the recommendations given by the IAU.

Risk The negligence of management to address recommendations given by the IAU poses an increased risk for repetition of weaknesses. Following up the events with an audit after they have occurred does not add value to improvement of operations or prevent errors and irregularities.

Recommendation 6 The Mayor should discuss an action plan with other management levels, assign staff responsible, and determine deadlines to address recommendations given by the internal audit. In addition, should be established process for monitoring of progress. When identified issues that need handling, the IAU are should focus more on current year activities, by giving a priority to areas where the risk level is considered high.

3 Financial Management and Control

3.1 Introduction

Our work on Financial Management and Control outside of the areas of Governance referred to above in Chapter 2, reflects the detailed work undertaken on Revenue and Expenditure Systems. As part of this we consider Budget management, Procurement issues and Assets and Liabilities.

3.2 Financial Management and Control Conclusion

The procurement for municipality remains a challenge and requires improvement, as regulations are not being implemented thus leading to poor value for money. Other areas where improvements are needed are revenues from lease of municipal property, assets management, as well as the establishment of measurable criteria upon granting subsidies.

3.3 Budget Planning and Execution

We have considered the sources 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 ¹	2015 Outturn	2014 Outturn	2013 Outturn
Sources of Funds	8,578,023	9,212,022	8,878,415	8,176,752	8,339,097
Government Grant -Budget	7,563,874	7,747,241	7,711,699	7,420,977	7,406,811
Carried forward from previous year ² -	-	411,741	391,906	106,245	144,464
Own Source Revenues ³	1,014,149	1,014,149	742,835	606,985	683,436
Domestic Donations	-	38,891	31,975	24,465	48,789
External Donations	-	-	0	18,080	55,597

The final budget is higher than the initial budget by €633,999. This increase is a result of Government's Decision to pay the work experience in the amount of €183,367; revenues carried forward in the amount of €411,741, and domestic donations in the amount of €38,891.

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.

Municipality used 96% of the final budget in 2015, approximately the same with the prior year (94%). Overall, this can be considered a good performance of budget execution.

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

Description	Initial Budget	Final Budget	2015 Outturn	2014 Outturn	2013 Outturn
Spending of funds broken down by economic categories	8,578,023	9,212,022	8,878,415	8,176,752	8,339,097
Wages and Salaries	5,340,000	5,523,366	5,519,858	5,046,011	4,318,168
Goods and Services	793,435	887,821	810,343	629,647	864,385
Utilities	135,338	161,835	161,046	126,008	187,559
Subsidies and Transfers	272,250	394,641	327,545	168,359	359,903
Capital Investments	2,037,000	2,244,359	2,059,623	2,206,727	2,609,082

Explanations for changes in budget categories are given below:

- The difference in the category of Wages and Salaries from the initial budget and the final budget is €183,366, as the Government of Kosovo had taken a decision to pay the work experience.
- In the category of Goods and Services, we have an increase in the final budget compared to the initial budget by €94,386. This increase was as a result of revenues carried forward from the prior year;
- As a result of revenues carried forward from the prior year, in the category of Subsidies there was an increase of the final budget compared to the final budget by €122,391; and
- In the category of Capital Investments, there was an increase of the final budget by €207,359. The increase is as a result of revenues carried forward in the amount of €168,468, and Domestic Donation in the amount of €38,891.

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

Description	Initial Budget	Final Budget	2015 Receipts	2014 Receipts	2013 Receipts
Own source revenues	1,014,149	1,014,149	941,133	936,047	683,436

The annual own source revenues during 2015 were collected at 93% out of the planned amount, which can be considered a significant degree of collection:

3.4 Procurement

Procurement expenditure totalled €2.1 million in 2015. Procurement rules are intended to ensure that public funds are used in a transparent and efficient manner to achieve value for money. The legal framework clearly defines the rights, duties, and responsibilities of all parties involved in public procurement. This includes the requirement to mitigate the risk of non-completion of contracts and poor contract execution. This is achieved through the implementation of a regime of penalties related to poor performance and execution security.

We have analysed whether the capital investment projects have been included in the PIP and in the medium term expenditure framework. In addition, we reviewed whether there were any changes in the projects foreseen to be implemented during the year. We consider that there are no issues that need to be raised in this report.

We have also assessed implementation of procedures and identified the following issues:

Issue 6 - Systematic Weaknesses in Procurement - High Priority

Finding

According to the Article 81 of the LPP and Article 55 of the Operational Guidelines on Public Procurement, the Contracting Authority has to draft a plan for management of a contract. We have identified that no plans were prepared for management of contracts signed for goods and services.

According to the AI No. 1/2014 on Preparing the Technical Specification for Contracts for Works, the Contracting Authority is responsible for project design and is not allowed to release tender documents without attaching a detailed description of the project. We have noticed that in four cases the municipality had signed contracts for works without executive projects.

In the contract "Drafting of the municipal Plan for Energy Efficiency 2014-2020" in the value of €5,850, were not developed procurement procedures. The contract for this service was entered into between the municipality and the Economic Operator under an agreement that the Mayor had concluded with the Economic Operator.

In the contract, "Demolition of Radusha building in Istog" in the value of €9,829 were not were not developed procurement procedures. The contract for this service was entered into between the municipality and the Economic Operator under an agreement that the Director of Public Services had concluded with the Economic Operator.

Risk The abovementioned cases show weaknesses in the procurement process. The presence of such phenomena during planning and execution is not in line with procurement rules.

Recommendation 7 The Mayor should ensure that a review is conducted to determine why the procurement requirements were not consistently applied on the abovementioned cases, by not evading procurement procedures, and design specific projects before initiating procurement procedures.

Issue 7 - Non-systematic weaknesses in procurement - High Priority

Finding In the framework contract for a period of two years "Sweeping and Washing of Streets and Sidewalks in Urban Areas of Istog", the yearly value of the contract was about €25,000. The contract was awarded to an irresponsible bidder who had not signed and stamped the form for submission of the Tender. The Tender Evaluation Committee had evaluated the winning Operator as responsive.

In the contract "Supplying with coal for Municipal institutions of Istog" Lot I - estimated value €25,000. The Municipality had awarded the contract to the Operator with the price of €57.85/ton, while it had eliminated from the competition the Economic Operator who had offered the price of €36/ton, even though the Tender Evaluation Committee classed both bidders as eligible.

In the contract "Construction of Sewage System in the village of Cerrcë - Lubozhdë" in the value of €91,654, even though the bidder had met the criteria of the Tender Dossier, prior to entering the contract, the procurement office had requested a certificate from the Tax Administration of Kosovo that proves that he is not late in payment of taxes, at least until the last quarter. While according to tax certificate the winning bidder had an agreement with the Tax Administration of Kosovo to pay off remaining tax debts in instalments. The contract was entered into between the Municipality of Istog and the winning bid that was irresponsible, which is in disagreement with the LPP, namely Article 65 paragraph 4.8.

Risk Due to lack of implementation of the criteria established under the Tender Dossier are selected winning bids in an inadequate manner, is harmed the competition and transparency of the process, and as a consequence are purchased goods, works or services with higher prices than those in the market.

Recommendation 8 The Mayor should review why procurement requirements were not implemented in the abovementioned cases and apply additional controls to ensure that such situations are not repeated in the future.

3.5 Expenditure not related to Procurement

Other expenditures are expenditures that are not subject to procurement procedures. In expenditures not related to procurement, we noticed the following issues:

Issue 8 – Payments under the agreement and contracts for special services - High Priority

Finding

On 04.02.2015, the Mayor had signed a cooperation and co-financing agreement with Caritas Kosova for the project “Home Mobile Medical Care - Home Care 2015”, in the amount of €92,130. With this agreement the municipality was obligated to participate with €61,970, while Caritas Kosova should have participated with €30,160. The Municipality had paid the amount of €31,000 in March, while the remaining amount of €30,970 was paid in July only based in the agreement, without receipts and reports that confirm whether the works, goods, or services are delivered. Caritas Kosova has submitted a summary report on conducted activities, but the report does not contain detailed information. The Municipality had taken these funds out of the economic category of Capital Investments - Economic Code 33200 - Capital Transfers. The portion that was committed to be invested by the donor (€30,160), the municipality does not have information whether the donor has actually invested the funds in line with the agreement.

The Municipality has hired workers with contracts for special services. We have identified that 17 contracts have a longer duration than six months, and among them there were also contracts that were entered into in 2010. According to Article 12, paragraph 4, of the Law on Civil Servants, contracts for special services can be entered into for a shorter period than 6 months.

Risk

It is not clear why the municipality is being subjected to such terms of agreement, where payments are paid months before the start of project implementation, as this poses a significant risk for payments being carried out while projects are not implemented.

Renewing contracts for special services poses a risk where services obtained may not meet the real needs of the municipality, and the budget planned for this category not to be spent for the purposes specified. Moreover, can be hired staff members that are not competent and services delivered to be of poor quality.

Recommendation 9 The Mayor should ensure that upon co-financing in the future, it will be an active and equal party in terms of follow up, implementation and oversight of these projects. Practices such financing and payments made under these agreements should be stopped, and instead insist that all payments are made only after the receipt of services and based on invoices and to the progress of the agreements, and no prepayments., further, contracts for special services are used for specific purposes where really no shortage of staff as well as their duration do not be over 6 months as defined by the law. We suggest that such practices are not repeated.

3.5.1 Remunerations (Wages and Salaries)

The budget planned for the category of Wages and Salaries was €5,523,366, while the expenditures were €5,519,858€ or 99%.

We have tested the compliance of payroll lists, recruitments, dismissals, maternity leaves, pensions, and payments for Municipal Assembly members. In addition, we have reviewed whether the employees have been paid in line with the contract, and we have not come across any issues that need to be raised, with the exception of the following case.

Issue 9 - Failure to reconcile job positions between contracts and payroll list - Medium Priority

Finding Our recommendation given in the audit report for not reconciling 16 job positions in agreement with contracts and payroll has not yet been implemented. As of 2010 the municipality has 16 heads of personnel on the payroll, while in fact with a contract there is only one head of personnel, while the others work contracts are: certifying staff, expenditure personnel, head of sectors, coordinators for gender equality, etc. This has taken place as heads of municipal departments in 2010 had decided to increase multipliers from 7.5 to 9.5 for 16 employees.

Risk Increasing multipliers for 16 employees creates dissatisfaction among the employees of the municipal administration. Furthermore, this is not in the power of municipal directors, and by doing so are evaded decision-making responsibilities of the Mayor (Article 13 of the Law on Local Self Government stipulates that only the Mayor has the right to take certain decisions or issues certain orders).

Recommendation 10 The Mayor has to look into this issue and determine why have these irregularities occurred in the process, and have been repeated for years, and to ensure that in the payroll system will not be processed payments based on fictive contracts.

3.5.2 Subsidies and Transfers

In 2015, the Municipality has awarded subsidies to public and private entities. From this category, we have tested and reviewed whether these payments are in accordance with the regulation on award of subsidies. Some of the shortcomings have been presented below:

Issue Issue 10 – lack of evidence upon selecting winners – Medium Priority

Finding The Municipality had subsidised the construction of individual greenhouses with a value of €60,000, where had applied 303 farmers. According to the report of the committee 90% of them had met the criteria set out in the competition, while have benefited 93 farmers. We were not provided evidence on how these 93 beneficiaries were selected out of 303 applicants.

Risk Due to lack of clear and measurable criteria, the municipality is exposes to risk, as upon selecting beneficiaries may not select the beneficiaries.

Recommendation 11 The Mayor should ensure that upon subsidising farmers an objective and transparent process is applied based on clear and measurable criteria.

3.6 Own source revenues

Revenues generated by the municipality in 2015 totalled €1,180,319. Main items that constitute the amounts collected are: revenues from property tax; taxes from registration of vehicles; revenues from administrative fees etc.

Issue 11 – Property tax – High Priority

The Law on Budget for 2015 - tables 4.3, medium term of total revenues of the municipal budget shows that Municipality of Istog had planned to collect from property tax the amount of €695,628, while according to the municipal data, revenues planned for this account were €295,009, namely we have an inconsistency between planning according to the budget and the planning based on municipal data. During the year were invoiced 10,410 taxpayers that totalled €332,806, while the collection from this account was €292,128. We have tested seven samples from the property tax, and noticed that debts for 2015 only for these samples were €9,963. Total debt accumulated until the end of 2015 from property tax was €903,431.

The Municipality had not managed to carry out the verification of 1/3 of immovable properties, as required by the Law on Tax for Immovable Property No. 03/L-204 and applicable Administrative Instruction. We have noticed that the municipality has not managed to update the system with information, as there was a lack of survey officers on the ground to verify properties.

The Article 9 of the Law on Taxes on Immovable is stipulates that “Every natural person who, on or before 1 March of a tax period, establishes that the property or residential unit serves as his or her principal residence shall be allowed a deduction of ten thousand (10,000) Euro from the taxable value of the property”. We have identified that in six cases the Municipality had not acted in accordance with the law as there were taxpayers who owned two or more registered properties as main residence and for each residence was applied the deduction of €10,000.

Risk

Failure to verify 1/3 of properties can result in incomplete information on current taxable property, with a potential impact on decrease of property tax.

Failure to apply charges in line with legal requirements on property tax increases the risk of having lower revenues from this category.

Recommendation 12 The Mayor should ensure that verification of municipal property is done as foreseen under the law, so that all potential changes of properties that are valuable to the taxable base are integrated in the database. Furthermore, additional actions are undertaken to ensure that deductions of €10,000 are applied in line with Article 9 of the Law on Taxes on Immovable.

Issue 12 - Revenues from lease of municipal property - High Priority

Finding

The Municipality of Istog had leased 365 hectares of municipal property (arable land) to 49 individuals with a price per hectare €30. We were not provided any evidence on how this fee is set. In addition, the municipality had not organised public auctions to lease this property as required under the Law 04/L-144 on Allocation for Use and Exchange of Immovable Property of the municipality. In addition, we have tested six samples of municipal property leases and have identified the following weaknesses:

The Municipality had established a committee to identify all users of public spaces in front of their business premises. This committee had determined that around 73 business entities use this space. According to municipal Regulation on taxes, fees and fines, users were supposed to pay to the municipality the amount of €3,453, but only 13 users have responded to the letter for payment, where they paid the amount of €477 to the municipality. The Municipality had not taken any measures to ensure that other users meet their obligations.

Risk Leasing municipal property without a public auction poses a risk for wrong selection, limits market competition and undermines the principle of free competition and equal treatment for all parties interested. In addition, use of public spaces without meeting obligations that arise from municipal Regulation on taxes and charges, risks collection of remaining obligations. This can cause significant financial losses to the municipality.

Recommendation 13 The Mayor should ensure that public auctions are organised when leasing municipal property, in order to have an open and transparent process, and to increase mechanisms and exercise constant monitoring over the use of public spaces, so that they are not used prior to meeting obligations in line with the municipal Regulation.

3.7 Assets and Liabilities

3.7.1 Capital and Non Capital Assets

In 2014, the net value of assets in the accounting register was €12,262,984, while in 2015 this value has increased to €13,928,994. As seen the municipality had continued with the property recording process and has made good progress in 2015, but until the completion of a final assets register, much remains to be done.

Issue 13 – Lack of a complete assets register and inconsistencies with the Regulation on assets management - High Priority

Finding The Municipality does not have written internal procedures for management of assets, as required under the Regulation 02/2013 on assets management.

The Municipality has managed to identify 1540 that are owned by the municipality, but has not managed to record them in the accounting register as the properties do not have a financial value.

On 14.12.2015, the Mayor had established a committee for inventorying of non-financial assets owned by the municipality for three Departments: Administration, Health, and Education. According to the Regulation on assets management, the committee should have finished its work by the end of the fiscal year, so that changes could be reconciled with the AFS for 2015, but the committees were late in completing their work. The committee of Department of Education had carried out the work late on 23.03.2016, The Department of Administration on 07.03.2016, while the Department of Health on 07.03.2016, thus the changes identified could not have been reconciled with the AFS.

The Municipality of Istog did not have effective controls for monitoring and reporting the use of official vehicles, as municipal officials have used vehicles without filling out the request form for temporal use of official vehicle, and obtaining the approval. In addition, each vehicle user was obligated to write in the form the number of kilometres of the vehicle at the time of departure, destination, purpose of travel, names of individuals traveling, the number of kilometres at the time of arrival as well as the signature of users. There were cases when the travel form was not completed and in many cases the information was incomplete. Municipality' Regulation on use of official vehicles was not fully implemented.

Risk Incomplete recording of assets owned by the municipality increases the risk of underestimation of municipal assets and incorrect presentation of assets value. In addition, failure to accurately report on vehicle use increases the risk of misuse, and incurring of irregular expenditures and financial losses.

Recommendation 14 The Mayor should ensure drafting of an internal guideline on assets management wherein roles and duties of certain officials who have to contribute to preparation of data on assets that need to be recorded are clarified, and then all assets are correctly presented in the AFS. To ensure that adequate controls are applied to ensure that vehicles are used for official purposes.

3.7.2 Handling of Receivables

The Municipality had not managed Accounts Receivable. In the following we are presenting our findings on this account.

Issue 14 - Poor management of Accounts Receivable - Medium Priority

Finding The Accounts Receivable for 2015 were in the amount of €953,000. Compared to the prior year (€1,323,186), it appears that they have decreased, but we were not provided any evidence that demonstrates how these Accounts were reduced, therefore we cannot provide assurance on the accuracy of these Accounts. In addition, the amount of €176,000 as arrears from business fees and the amount of €7,120 as taxes from non-alcoholic beverages were not included in the 2015 AFS.

Risk Failure to report correctly Accounts Receivable or deletion of these Accounts from the AFS without a document (decision) proving debt pardoning procedures increases the risk of misunderstanding the financial position of the municipality.

Recommendation 15 The Mayor should ensure that the removal of Accounts Receivable from the AFS will be conform to legal requirements wherein procedures will be established clearly as well as the manners in which they are paid off. Furthermore, to ensure that Accounts Receivable are presented correctly in the AFS.

3.7.3 Handling of debts

The statement of outstanding liabilities owed to suppliers at the end of 2014 was €86,625. These liabilities are carried forward to be paid in 2016.

Issue 15 - Failure to report outstanding liabilities in accordance with Treasury Regulation - Medium Priority

Finding Even though the municipality has been recommended in last year's report by the OAG to report monthly liabilities in line with Article 5 of Regulation 02/2013 to the Ministry of Finance -Treasury, while the municipality had not done this.

Risk Failure to report outstanding liabilities increases the risk for municipal liabilities not to be presented fairly in the AFS and impedes correct budget planning of the following year.

Recommendation 16 The Mayor should ensure that the reporting of outstanding liabilities is done in the Treasury on monthly basis and are undertaken measures so that that invoices are paid within the legal deadlines.

This report is a translation from the Albanian original version. In case of discrepancies, Albanian version shall prevail.

ANNEX I Audit Approach and Methodology

The responsibilities placed on the Auditor and Those Charged with Governance are detailed in the Opinion set out in Section 1.2 of this report.

While a key output of our work is the audit opinion this report reflects the totality of our work with specific focus also on Governance Issues including Financial Management and Control. The latter is informed by our extensive, risk based, compliance audit programme.

The Executive Summary is intended to highlight the key finding of the audit and the key actions that the Mayor should ensure are taken to address identified management/control weaknesses.

The detailed report provides an extensive summary of our audit finding with emphasis on determining the cause audit findings and providing appropriate recommendations to address these. For completeness we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

High Priority - issues which if not addressed 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 significant improvements to the efficiency and effectiveness of internal controls.

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

Our procedures included a review of the internal controls and accounting systems and associated substantive testing and associated governance arrangements 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.

Annex II 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 III: Prior Year Recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
2.2 Significant Risks to the Annual Financial Statements	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.			X
2.2 Significant Risks to the Annual Financial Statements	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.		Partially	
2.3 Compliance with AFS and other reporting requirements	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.			X
3 Prior Year Recommendations	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.		Partially	
4 Governance	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.			X

4.1 Budget Planning and Execution	The Mayor should ensure that invoices are paid in time and that the risk of payments being made through court decisions is avoided.		Partially	
4.2 Revenues (including own source revenues)	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.			X
4.3.1 Procurement	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.		Partially	
4.3.1 Procurement	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.	X		
4.3.2 Other expenditures	The Mayor should ensure that no investments are made in private assets and exercise his powers according to the Law on Local Governance.	X		
4.3.2 Other expenditures	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.	X		

4.3.3 Remunerations (Wages and Salaries)	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.		Partially	
4.4.1 Capital and Non Capital Assets	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.		Partially	
4.4.2 Handling of Receivables	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.			X
4.4.3 Handling of Debts	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.			X
4.5 Internal Audit System	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.		Partially	