



REPUBLIC OF KOSOVA
OFFICE OF THE AUDITOR GENERAL

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

Prishtina, June 2013

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

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

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

The Auditor General has decided on the audit opinion and the report on the Annual Financial Statements of the Municipality of Prizren in consultation with the Assistant Auditor General, Qerkin Morina, supervising 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), Faik Thaqi, Evetar Zeqiri and Shpresa Zenelaj.

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Executive Summary

Introduction

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

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

Our audit focus has been on:

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

Opinion

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

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

Failure to present third party payments. At statement of receipts and cash payments, within the column of third party payments, the Municipality did not disclose any value, whereas our audit examinations shows that the value of these payments was €712,079; and

Article 13 Statement of Budget Execution, note 16 donations, the Municipality did not present any value, and according to FreeBalance records, the value of these donations was €451,730.

(ISSAI 400 Qualified Opinion)

Emphasis of Matter

Furthermore, we would like to draw your attention to the fact that records and information presented within assets disclosures and stocks were not accurate. Inaccuracies were as follows:

Note 30: Summary of non-financial assets – even though the value of €480,940,000 was disclosed, this amount was not accurate, we have identified assets in value of €574,433 that were not disclosed in AFS; and

Note 32: Summary of stocks in the end of the period, the Municipality presented the value of €7,000 whilst according to records provided the value of stocks was €18,789; there is a difference of €11,789.

Overall Conclusion

Our overall conclusion reflects our review of controls related to AFS, Financial Management and Control, compliance of payment and receipt procedures and Internal Audit System.

Our overall conclusion is that:

A number of improvements were made by management in 2012, which boosted the range of procedures and processes when it comes to financial control, for example, improved the asset recording, strengthened the Audit Committee. However, there is room for improvement in order to ensure comprehensive and consistent application of appropriate controls in all municipal activities, with particular emphasis on preparation of Financial Statements in line with legal requirements. Weaknesses are detailed below.

Audit recommendations are intended to support Prizren Municipality in improving financial controls and enhancing other aspects of operational activity. We have considered the response to our recommendations made in 2011 – the current position is summarised in Annex II. Our overall conclusion is that additional emphasis is needed when it comes to implementing audit recommendations in order to avoid ongoing weaknesses of control.

We discuss the quality of Municipality's financial reporting and our detailed audit findings with regard to the Annual Financial Statements, Financial Management and Control and Management Accountability and Internal Audit with the management of the Municipality.

Our key recommendations for the Mayor are as follows:

Annual Financial Statements

- The Mayor should ensure that the AFS are prepared fully in compliance with Treasury Rule no.07/2011, with all supporting information.

Financial Management and Control

- Improve the policy for proper budget planning, by carrying out all analysis within sectors and prioritising the real needs for each category;
- Enhance controls at construction licenses revenues, initially ensuring that there is a complete and accurate database and to put in place efficient mechanisms for collecting old debts;
- Adding controls to the procurement process by complying with criteria set in the tender files;
- Not splitting tenders with the aim to avoid open procurement procedures;
- Approve the Regulation on Subsidies and Transfers;
- Further strengthen the internal control system, in order to eliminate existing system's weaknesses; and
- Record all Municipality owned assets and continuously update asset records.

Internal Audit System

- Management should pay greater attention to addressing IAU recommendations; and
- The IAU is completed with additional staff, as required by Administrative Instruction no. 23/2009.

Management Response – 2012 audit

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

1 Audit Scope and Methodology

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

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

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

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

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

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

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

Our procedures included a review of the internal controls and accounting systems and procedures only to the extent considered necessary for the effective performance of the audit. Audit findings should not be regarded as representing a comprehensive statement of all the weaknesses which exist, or all improvements which could be made to the systems and procedures operated.

2 Annual Financial Statements

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

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

2.1 Compliance with the Reporting Framework

Overall Conclusion

AFS were prepared according to the standard format required by the Financial Rule no. 07/2011, but during the audit, we have found that some of the data presented in the AFS were inaccurate and incomplete. For more thorough description they are presented in Sub-chapter 2.2 Quality and Accuracy of Information.

Description

The AFS are required to comply with a specified reporting framework. We noticed that:

- AFS were prepared within the time frame and delivered to MoF;
- AFS were signed by Chief Administrative Officer (Mayor) and Chief Financial Officer;
- AFS were submitted in Albanian and serbian;
- AFS were prepared in hard and electronic copy, and
- The Municipality prepared and submitted regular quarterly reports to the MoF Minister in 2012.

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

Overall Conclusion

AFS prepared on 31.01.2013 for the year ended on 31.12.2012, did not comply with the requirements of the Financial Rule no. 07/2011. They were incomplete and inaccurate.

1. Issue - Accounts Production Process - Priority - Significant

Finding

Article 12: Statement of receipts and payments in cash, the column-payments from third parties, the Municipality did not submit any value, while based on the data we have obtained from the Municipality, the value of third party payments was €712,079;

Article 13: the budget execution statement, note 16 - Donations in column-final budget and outturn, Municipality did not presented any value, while according to Free Balance records, donations for Municipality were in amount of €451,730;

Note 32: Summary of stocks at the end of the period, the Municipality presented the value of €7,000, whereas according to data obtained from warehouse officers; stock value was €18,789, a difference of €11,789;

Note 30: Summary of non-financial assets, the value of assets presented in the AFS was incorrect, since it did not include all assets that Municipality owns. We have identified assets in value of €574,433 which were not presented in AFS.

Risk

Financial statements are incomplete and contain errors. Accounting records are insufficient to support management's decisions, processes making and budget considerations.

Recommendation 1

The Mayor should ensure that the 2013 AFS production plan formally addresses all compliance requirements and includes the review of recommendations given by OAG in 2012.

2.3 Audit Opinion

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

Failure to present third party payments. At statement of receipts and cash payments, within the column of third party payments, the Municipality did not disclose any value, whereas our audit examinations shows that the value of these payments was €712,079; and

Article 13 Statement of Budget Execution, note 16 donations, the Municipality did not submit any value, and according to FreeBalance records, the value of these donations was €451,730.

(ISSAI 400 Qualified Opinion)

Emphasis of Matter

Further more, we would like to draw your attention to the fact that records and information presented within assets disclosures and stocks were not accurate. Inaccuracies were the following:

Note 30: Summary of non-financial assets - although the value of €480,940,000 is not accurate given that we have identified assets in value of €574,433 which were not disclosed in AFS; and

Note 32: Summary of stocks in the end of the period, the Municipality presented the value of €7,000 whilst according to records provided the value of stocks is €18,789. Therefore, there is a difference in the value of €11,789.

3 Prior Year Recommendations

Overall Conclusion

Municipality management handled our last year recommendations, but the level of addressing remains low in order to be able to take assurance that identified weaknesses and shortcomings are adjusted.

Description

Our audit report in the Financial Statements 2011 resulted in nine (9) recommendations. Municipality's management prepared an action plan stating that all recommendations should be addressed.

At the end of our audit we noticed that 2 (two) recommendations were fully addressed; 3 (three) were partially addressed or are in process of being addressed, and 4 (four) were not addressed. . For a more thorough description of the recommendations and how they are addressed, see Annex II.

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

| | |
|-------------------------|--|
| Finding | Municipality partially addressed prior year recommendations. |
| Risk | Failure to fully address the recommendations shows that in some areas, the same problems from 2011 continue to exist and prior year recommendations can be repeated. |
| Recommendation 2 | The Mayor should ensure that the revised action plan clearly sets out a timetable for addressing the recommendations with staff members accountable identified, with initial focus on those of greater importance. |

4 Financial Management and Control

4.1 Introduction

Our audit approach is focused on understanding and evaluating the actions taken by management to secure effective financial management and control. For individual financial systems we seek to identify the level at which actual controls operate. This may, for example, be monitoring activity undertaken by senior management or lower level operational controls. 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.

We appreciate the selfassessment made by the management according to Financial Management and Control requirements.

4.2 Budget Planning and Execution

Overall Conclusion

Municipality spent 91% of its budget, in accordance with applicable rules and limits set by the Assembly. A lower expenditure level is noticed within Capital expenditures of 83% of the budget. Reasons for not spending the funds in this category were: delays in projects execution and not collecting planned own source revenues – foreseen for capital projects.

Description

We have considered the source of budgetary funds for Prizren 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 | 2012 Outturn | 2011 Outturn | 2010 Outturn |
|--------------------------------------|-------------------|---------------------------|-------------------|-------------------|-------------------|
| Sources of Funds | 31,595,018 | 33,165,749 | 30,274,490 | 32,018,274 | 25,229,783 |
| Government Grant - Budget | 26,104,343 | 26,154,343 | 25,683,770 | 26,073,952 | 21,119,192 |
| Carried forward from previous year - | - | 1,069,000 ² | 976,455 | 1,436,952 | 734,910 |
| Own Source Revenues | 5,490,675 | 5,490,675 ³ | 3,317,382 | 3,892,448 | 3,033,560 |
| Domestic Donations | - | 243,815 | 125,611 | 167,400 | 284,442 |
| External Donations | - | 207,916 | 171,272 | 447,522 | 57,679 |

Final budget differs from the Initial Budget for €1,570,731. This difference is due to the transfer of the previous year Own Source Revenues amounting to €1,069,000, undesignated donor grants in the amount of €451,731 and from additional €50,000 upon Government's decision for the capital project "Construction of the road Kurilë - Novoselan" in Prizren.

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

| Description | Initial Budget | Final Budget | 2012 Outturn | 2011 Outturn | 2010 Outturn |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|
| Spending of funds broken down by economic categories | 31,595,018 | 33,165,749 | 30,274,490 | 32,018,274 | 25,229,783 |
| Wages and Salaries | 14,830,293 | 14,897,153 | 14,856,793 | 14,403,387 | 11,129,125 |
| Goods and Services | 2,186,459 | 2,337,815 | 2,082,843 | 2,133,270 | 2,340,380 |
| Utilities | 706,534 | 806,534 | 802,796 | 638,217 | 616,552 |
| Subsidies and Transfers | 360,979 | 360,979 | 350,288 | 351,636 | 372,004 |
| Capital Investments | 13,510,753 | 14,763,268 | 12,181,770 | 14,491,764 | 10,771,722 |

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

² The Municipality's own source revenues not spent in previous year, but carried forward in the current year.

³ Municipal planned own source revenues.

Table 3. Municipality's planned and collected revenues

| Description | Initial Budget | Final Budget | 2012 Outturn | 2011 Outturn | 2010 Outturn |
|---------------------|----------------|--------------|--------------|--------------|--------------|
| Own source revenues | 5,490,675 | 5,490,675 | 4,339,726 | 4,999,000 | 4,434,000 |

Municipality collected 79% of the planned revenues. There were significant delays in revenue collection for commercial business licenses and revenues from traffic fines. If we compare decrease of revenues in 2012 with 15% in relation to 2011, we see that this occurred mainly due to traffic fines which were not collected according to plan including and revenues from business activity licenses.

4.3 Reporting Requirement

Overall Conclusion

In terms of external financial reporting requirements, we can conclude that Municipality has met and complied to required time frames.

Description

We have concluded that Prizren Municipality met all external reporting obligations. Fulfilled obligations are as follows:

- Budget request to MoF for financing capital project;
- Quarterly reports including nine month financial statements in time;
- Draft and final procurement plan in time;
- Operational (performance) reports;
- Reports on debts submitted to the MoF;
- Action Plan on implementing recommendations; and
- Reports on Internal Control, including self assessment report.

4.4 Revenues (including own source revenues)

Overall Conclusion on Revenues

Prizren Municipality formally established controls over revenues, but controls as such require further improvements, especially having a completed database on construction licenses and leased properties, securing that leaseholders carry out their obligations towards the Municipality according to contract. Municipality should produce clear policies with appropriate mechanisms for collection of debts from earlier years.

Description

Revenues generated by Prizren Municipality in 2012 totalled €4,339,737. The source of revenues is from property tax, construction licenses, administrative fees, etc.

3. Issue - Property tax - Priority Significant

Finding From property tax for 2012, Municipality planned to collect €1,156,000; the collected amount was €1,234,040. We tested 48 samples from property tax in the amount of €189,272, and we noticed that in five cases the amount of €8,099 was paid for property tax, whereas in 43 cases it was not paid at all. In addition, the amount of liabilities accumulated over the years amounts to €5,288,507. Municipality failed to draft a plan or strategy to collect old debts.

Risk Property tax is the only tax collected by Municipality; therefore, it represents one of the main revenue sources. Negligence in collecting this tax increases the risk that planned revenues are not collected and reduces the possibility of executing planned self-financed projects.

Recommendation 3 The Mayor should have a comprehensive approach on handling revenues, in terms of planning and in terms of establishing effective mechanisms for achieving planned parameters. Management should initiate a reassessment process, where all accounts are analysed in terms of long-standing, significant amounts, realistic collection possibilities and application of administrative measures (if necessary).

4. Issue - Construction licenses - Priority - Significant

Finding From construction licenses for 2012, Municipality planned to collect revenues in value of €800,000; whereas it collected only €843,346 . We tested 8 samples in value of €274,582 and identified the following deficiencies:

- We were not able to obtain a complete database on the number of permission requests for licenses, issued licenses and refusals for 2012; and
- In three cases, we found that Municipality issued a decision to build two floors, while inspectors in the field noticed that there was an overrun construction of buildings and more floors were built than allowed by construction license.

Risk Lack of a comprehensive database for construction licenses, as well as the excess of the permitted building floors, increases the risk of having incorrect calculated fees and a revenue underpayment.

Recommendation 4 The Mayor should establish an accurate database on the number of applications filed for licenses, licenses issued and those rejected. In addition, construction excesses cases should be reviewed and as such cases contracts should either be terminated or additional fees are charged.

5. Issue - Lease revenues - Priority - Significant

Risk From properties leased, Municipality planned to collect €420,284 while €290,863 was collected. We have tested 10 samples and have identified the following deficiencies:

- In one case, the Municipality signed a contract in 2008 with a leaseholder for the premises in value of €1,025 per month and the leaseholder did not adhere to the terms of contract. Upon Mayor's conclusion on 13.07.2010 the lease is reduced at €850, but the lease was not paid. Unpaid lease reached the amount €16,265;
- In another case in 2002, Municipality signed a lease contract for six years, with the possibility of extension for another four, while the municipality signed a new contract in 2012 for four additional years, which is in contradiction with basic contract. The leaseholder did not make payments on regular basis and outstanding liability to Municipality reached €51,400.

-
- In four cases, Municipality entered into a lease contract for the use of the property and business premises. In all cases, the lease holders did not make any payments. The total of liabilities was €44,109. Municipality filed a lawsuit concerning this case.

Risk Failure to pay obligations from lease contracts, by leaseholders, and reducing lease amount according to Mayor's decision, increases the risk that leaseholders avoid payments and reducing Municipality's revenues.

Recommendation 5 The Mayor should ensure that all contractual obligations are implemented by leaseholders on regular monthly basis. On the contrary, the Municipality should terminate contracts. The management should carry out ongoing reviews of contracts and should strengthen controls.

6. Issue - Business activity fee - Priority - Significant

Finding Municipality's planned revenues from this activity were €600,000, while 272,467 or 45% were collected. Such a major difference between the plan and its execution is because this type of tax is no longer collected by the Municipality. Total debt to the Municipality from this revenue category from 2001 to 2012 is €7,161,205.

Risk Non-collection of old debts has an impact in reducing the total budget, and in failure to execute many self-financing planned projects.

Recommendation 6 The Mayor should increase its activity to increase the debts collection which remained uncollected from previous years.

4.5 Expenditures

Overall Conclusion on Expenditures

Although Municipality established formal controls on expenditures, our testing shown that they do not operate properly. Payments for some items out of technical specifications, splitting of tenders aiming to avoid open procedures, awarding ineligible bidders, are only few cases describing control failures.

4.5.1 Procurement

Description

Contracts for 2012 subject to procurement procedures were in the amount of €13,630,167.

We have analysed whether or not Capital Investment projects have been included in PIP and in the Medium Term Expenditure Framework. We also reviewed whether any changes appeared associated with projects planned to be implemented during the year. We assessed that there were no related issues to raise in this report.

We examined 89 samples (payments), amounting to €4,590,850. Except the cases identified as follows, procurement procedures were in line with applicable legislation.

7. Issue - Failure to comply with criteria within tender dossier - Priority - Significant

Finding

The contract "Construction of the fence around the primary school yard in the village Zhur" in value of €38,905, two companies bided as a consortium, while one of these companies did not meet the criteria required by the tender dossier such as: technical equipment, references for similar works, the staff's list (certified by the Tax Administration).

In contract "Roof construction for Abdyl Frashëri school in Prizren" in the amount of €64,217, as a mandatory criterion in the tender dossier was that the operator should have had the project manager's statement, where the winning company didn't submit this document.

In the contract for wood supply for the needs of schools in the Municipality of Prizren, in the amount of €147,934, criterion in the tender dossier was that economic operator should possess 20% of wood in its warehouse, whereas, we have found that the winning company didn't provide evidence confirming that this amount was in its stocks, as required in the tender dossier.

Risk Failure to comply with the criteria set out in the tender file, during bids evaluation, increases the risk of selecting ineligible bidders.

Recommendation 7 The Mayor should ensure that in all procurement cases, bids are evaluated objectively and that all requirements set in the tender files are strictly adhered to.

8. Issue - Vehicle maintenance and service expenditures- Priority - Significant

Finding Our review of payments for maintenance and vehicles repair identified that:

- Municipality made expenditures with no contract and without procurement procedures for maintenance and repair of the Mayor's vehicle, in the amount of €3,977. These expenditures relate to periods from 2008 to 2012. We reviewed these payments and noticed a double payment for the invoice 1892/S in the value of €336. This invoice was introduced in the invoice summary No. 001 dated 10.04.2012 and also as a separate invoice dated 12.12.2011.
- In an open tender for the servicing and maintenance of vehicles, divided in two lots, the Municipality signed a contract with EO "Rex Automobile" for supplying parts for Lot 1 and for Lot 2 with EO D.P.Z "LML-COM" for vehicles servicing and transportation. We have reviewed the payment of €4,737 made to "LML-COM" and noticed that the Municipality was supplied with vehicle parts in the amount of €3,585, although they were not contracted with this operator.

Risk Failure to follow proper procurement procedures and instructions resulted in irregular payments and financial loss to the Municipality. There is a further risk that poor value was reached for money spent on this contract.

Recommendation 8 The Mayor should review reasons why public procurement requirements were not applied in these cases and should ensure that proper controls are in place in order that such situations are not repeated.

9. Issue - Splitting tenders in order to avoid open procurement procedures - Priority - Significant

Finding At contract "Design and printing of the Pocket Guide "Visitors" in the city of Prizren, and Design and printing of the archaeological Guide in the city of Prizren, in the amount of €9,930 and €9,950, the request was made by the Department of Economic Development and Tourism at the same date on 05.07.2012. Procurement Department, for similar services, applied price quotation in order to avoid open tendering procedures, where the same economic operator is selected for both contracts.

Risk Splitting tenders with the aim of avoiding open procurement procedures, presents potential risk for higher costs for purchased goods or services and does not provide equal opportunities for other competitors.

Recommendation 9 The Mayor should ensure that when submitting requests for supply, initially the needs are planned better, in order that there is no splitting of tenders with the aim of avoiding open procurement procedures.

4.5.2 Remunerations (Wages and Salaries)

Description

The planned budget for Wages and Salaries category was €14,897,153, while expenditures were at maximum, €14,856,793 or nearly 100%.

Wages and Salaries are paid through a centralised system (payroll). Controls operating locally by municipality relate to: a) control of payments on monthly basis by signing the

payroll list, b) verifying possible changes that may occur through forms, c) budget review for this category and reconciliation with Treasury.

For this category we tested 49 samples, reviewed compliance of salary payroll list with the payroll system in MPA. We have also looked into whether the officers' post and their multipliers are in line with the payroll system and payroll lists. Our tests in this category identified the following issues:

10. Issue - Processing of salaries - Priority - Significant

Finding

Our review of employee's salaries identified that Municipality:

- Paid an employee on maternity leave with 100% of salaries for the first four months. The Labour Law foresees that 70% of the salary should be paid. Also, the payment was not stopped for the month when payment is supposed to be done by the Ministry of Labour and Social Welfare for 50% of the average salary in Kosovo.
- In case of a transfer from a civil servant into political staff position as a Director of Health, we have noticed that due to not commencing changes in time, the person was over paid for €348..
- Department of Education continues to have a total of 28 contracted teachers not included in payroll as regular employees.

Risk

Personnel Office did not update personnel files and as a result, these incorrect payments incurred.

Recommendation 10 The Mayor through his mechanisms should make a systematic review of personnel files in order to ensure that all staff changes are included and the payments are updated. Overpayments should be returned to Kosovo budget within a specified period of time.

4.5.3 Subsidies and Transfers

Description

The budget appropriated for Subsidies and Transfers category was €360,979, while expenditures were €350,288. These subsidies were mainly appropriated for public entities

and non-public entities (individuals) according to Mayor's decision. We have tested 24 samples in this category in the amount of €101,591 and identified the following:

11. Issue - Legal base - Priority - Significant

Finding Municipality has no written regulation for appropriating funds for subsidies.

Risk Lack of internal policies/rules, reflects a lack of procedures which should be followed in case of subsidies.

Recommendation 11 The Mayor, without further delay, should adopt a Regulation which clearly specifies the subsidy criteria, procedures and sources.

12. Issue - EO selection and lack of supporting documentation - Priority - Significant

Finding Emergency Department engaged an NGO for training and preparing fire-fighters and paid an amount of €5,440. We were not able to identify what kind of training was provided and how the subsidy beneficiary was selected. Furthermore, the beneficiary did not provide a financial report on use of these funds.

By reviewing public beneficiaries' dossiers, we identified that:

- In nine cases of different beneficiaries, we concluded that there were no requests from beneficiaries;
- In the case of subsidising Family Medicine Centre employees, in the amount of €3,360, purpose of the request was Systematic Visits to elementary- sendory schools in Prizren, on the other hand, the subsidy is used for a visit (workshop) in Albania (Durrës and Tirana).

Risk Lack of feedback, such as financial and other descriptive reports; do not assure that expenditures for Subsidies and Transfers have achieved their goal.

Recommendation 12 The Mayor should ensure that proper procedures and controls are in place when it comes to subsidy expenditures, in line with the initial appropriations.

4.6 Assets

Overall Conclusion on Assets

Municipality continued this completing asset registers this year as well, and we appreciate the efforts made in this aspect, although much work remains to be done in the future. An inventory and evaluation committee were established during the year, which prepared reports on their work. Inventory report was prepared with a delay therefore changes were not reflected in the final registers.

4.6.1 Capital and non-capital assets

Description

In 2011, the total value of net assets in the accounting register was €467,539,000, while in 2012 was €480,940,000.

13. Issue - Assets recording and updating - Priority - Significant

| | |
|--------------------------|--|
| Finding | <p>During the audit, we identified cases where the Municipality did not include the following assets in assets registry:</p> <ul style="list-style-type: none">• CHF (Cooprative Housing Foundation) donation for educational facilities amounting to €415,617;• Health facilities in the amount of €82,590;• Vehicles in the amount of € 76,226;• The vehicle received as donation from Ministry of Public Administration. |
| Risk | <p>Lack of complete assets registry, makes the assets identification difficult in order to confirm their physical existence, and increases the risk of their misuse, loss and alienation.</p> |
| Recommendation 13 | <p>The Mayor should ensure that all assets purchased are recorded. Further on, he should apply appropriate procedures and controls to identify all assets received as donation and record them according to AI 21/2009.</p> |

14. Issue - Compliance with Administrative Instructions - Priority - Other

Finding Our review identified issues that are not in compliance with Administrative Instruction 21/2009 on assets management.

- The legislation requires that the Inventory Committee prepares its reports before the end of fiscal year. The report was not prepared in time, it was approved on 26.02.2013;
- The identified assets out of use and which are not included in the registry, were neither handled nor removed from the internal registry;
- Assets received as donation from EULEX, in value of €38,905, which were sold later on, are not deleted from the internal registry;
- Legislation requires that the Assets Officer is under the CFO's supervision. Assets Officer is not under the CFO's supervision, but within the Administration Department.

Risk Cases identified above indicate insufficient controls on asset management. This increases the risk that assets may be alienated or not confirming their physical location.

Recommendation 14 The Mayor should strengthen asset management controls, by implementing AI requirements on asset management.

4.7 Handling of debts

Overall conclusion

Municipality reported its liabilities to Treasury under the MoF Rules and has proper controls in this area, because as soon as invoices are received from economic operators, they are processed for payment to the Finance Department.

Description

Statement of outstanding liabilities to suppliers at the end of 2012 was €932,661. These liabilities are carried forward to be paid in 2013.

15. Issue - Entering into liabilities more than the approved budget limits - Priority - Significant

Finding We noticed that for Utilities and Subsidies category, Municipality entered into liabilities more than the budget appropriated. The budget appropriated for Subsidies was €360,979 and €350,288 or 97% was spent, while the outstanding liabilities for this category are €79,390. Also, for Utilities €802,795 or 100% were spent, while the outstanding liabilities for this category, at the end of 2012, were €123,053.

Risk Weaknesses in drafting the required budget for Subsidies and Utilities have caused liabilities beyond the allowed budget parameters. Entering into liabilities more than the approved budget, may bring the Municipality in front of unexpected financial difficulties and facing possible legal disputes.

Recommendation 15 The Mayor through his mechanisms should make a detailed and realistic budget planning and that the utilization of funds is based on a clear cash flow plan, and in no case exceeds funds allocated for economic categories.

5 Internal Audit System

Overall conclusion on Internal audit system

Internal Audit Unit has done a good job, by producing reports in different fields and assisting senior management in having an overview on controls and activities operating in the Municipality.

Description

The Internal audit system is a key part of internal control and due to its importance we present it here separately. We consider the scope of internal audit work and the activity of the audit committee.

In 2012, IAU performed five audits according to plan, and managed to execute the entire plan. Audits covered activities for 2012 for the following areas: a) Budget and Finance, b) Municipality's own source revenues, c) own source revenues for educational institutions in Prizren Municipality, d) Asset Management and e) Procurement Office.

16. Issue - Addressing IAU recommendations - Priority Significant

Finding During the audit, we noticed that the management partially addressed the internal audit recommendations.

IAU has one auditor who is also the Head of the Unit. He prepared the 2012 annual audit plan, which was approved by the Municipal Management. AI no.23/2009 determines the number of audit staff depending on the budget. Under this Instruction, Prizren Municipality should have at least 3 auditors, thus this requirement was not met.

Risk Failure to address IAU recommendations increases the risk that errors, shortcomings and weaknesses are repeated. Lack of audit staff has an impact in not auditing all areas with risk for the municipality.

Recommendation 16 The Mayor should draft an action plan and determine how it intends to address internal audit recommendations. In addition, management should review IAU's completion with the staff needed.

6 Overall conclusion

Overall conclusion of our review reflects controls related to AFS, Financial Management and Control and Internal Audit System.

Our conclusion is that the Municipality's management designed the internal control system, but these controls operated poorly in all important financial management areas. Monitoring was weak to ensure that controls are functioning properly. The following we presented areas with more significant shortcomings:

AFS were prepared with lack of information, such as: third party payments, donations and disclosure of stocks, which as a whole exceed the materiality and lead to a Qualified Opinion. In addition, many assets have been identified as not registered.

Prior year audit recommendations were not handled to the required level. Only two of them were fully addressed, and half of them were not handled at all. The similar case is with implementing internal audit recommendations.

The Budget, although spent 91%, nearly three million still remained unspent, while in the other hand, 900 thousand euro of outstanding liabilities remained. This is not a good performance.

The area of own source revenues is more specific, where shortcomings and weaknesses are more significant. Only 79% of planned revenues were collected, which compared to last year reduced by 15%. Debts of over 5 million euro from property tax were not collected for years. It is the same with payments for leased facilities where large amounts of debts are uncollected.

Area of procurement is also associated with many irregularities, in particular: failure to adhere to the tender dossier criteria, supply with items out of contract, avoiding open procedures by splitting tenders, double invoice payments, payments before receiving technical services, etc.

Irregularities were also identified in the area of personnel, in staff recruitment as well as payments made outside the contract.

Despite earlier recommendations, the Municipality did not produce an internal regulation on Subsidies as well as documentation of payment was insufficient.

Substantive improvements of controls are needed to eliminate the shortcomings above.

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

(extract from ISSAI 400)

9. An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse (paragraph 14) or a disclaimer (paragraph 15) of opinion.

10. An unqualified opinion is given when the auditor is satisfied in all material respects that:

- a) the financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;
- b) the statements comply with statutory requirements and relevant regulations;
- c) the view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and
- d) there is adequate disclosure of all material matters relevant to the financial statements.

11. **Emphasis of Matter.** In certain circumstances the auditor may consider that the reader will not obtain a proper understanding of the financial statements unless attention is drawn to unusual or important matters. As a general principle the auditor issuing an unqualified opinion does not make reference to specific aspects of the financial statements in the opinion in case this should be misconstrued as being a qualification. In order to avoid giving that impression, references which are meant as "emphasis of matter" are contained in a separate paragraph from the opinion. However, the auditor should not make use of an emphasis of matter to rectify a lack of appropriate disclosure in the financial statements, nor as an alternative to, or a substitute for, qualifying the opinion.

12. An auditor may **not be able to express an unqualified opinion** when any of the following circumstances exist and, in the auditor's judgement, their effect is or may be material to the financial statements:

- a) there has been limitation on the scope of the audit;
- b) the auditor considers that the statements are incomplete or misleading or there is an unjustified departure from acceptable accounting standards; or
- c)]there is uncertainty affecting the financial statements.

13. **Qualified Opinion.** Where the auditor disagrees with or is uncertain about one or more particular items in the financial statements which are material but not fundamental to an understanding of the statements, a qualified opinion should be given. The wording of the opinion normally indicates a satisfactory outcome to the audit subject to a clear and concise statement of the matters of disagreement or uncertainty giving rise to the qualified opinion. It helps the users of the statements if the financial effect of the uncertainty or disagreement is quantified by the auditor although this is not always practicable or relevant.

14. **Adverse Opinion.** Where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position presented to the extent that an opinion which is qualified in certain respects would not be adequate, an adverse opinion is given. The wording of such an opinion makes clear that the financial statements are not fairly stated, specifying clearly and concisely all the matters of disagreement. Again, it is helpful if the financial effect on the financial statements is quantified where relevant and practicable.

15. **Disclaimer of Opinion.** Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to an uncertainty or scope restriction which is so fundamental that an opinion which is qualified in certain respects would not be adequate, a disclaimer is given. The wording of such a disclaimer makes clear that an opinion cannot be given, specifying clearly and concisely all matters of uncertainty.

16. It is customary for SAIs to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.

Annex II: Prior year recommendations

| Audit Component | Recommendation given | Recommendation fully addressed | Partly addressed | Not addressed |
|--|---|--------------------------------|------------------|---------------|
| 4. Financial outturn compared to approved budget | Financial controls on budget management are strengthened, in particular to reconcile the cash flow plan with the dynamics of operational activities (capital projects, supplies with goods and services), and review on a regular basis the changes in budget items, analyzing all deviations from the planned objectives. | Yes | | |
| 6.1 Revenue | <p>Will not make contract with debtors who are in debt towards the Municipality;</p> <p>Will increase inspection controls for all businesses which do not respond to debt payments, and penalties are put in place and applied on businesses arrears;</p> <p>All revenues are registered in proper economic codes; and</p> <p>Will update all records of taxpayers (businesses and physical persons) of the municipal tax according to loaded data to enrich registers with the appropriate data, and strengthen the collection controls based on time periods.</p> | | | No |

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|---------------------|--|--|--------|--|
| 6.2 Expenditures | <p>Procurement procedures begin in time and in accordance with legal requirements, and not primarily to perform the work or supplies, and then to conduct formal procedures. Also, no contract shall be signed with operators which do not meet legal requirements;</p> <p>All payments shall be executed in accordance with the requirements of the contract and only after appropriate verifications are made that the contracted goods/services have been received in proper quantity and quality;</p> <p>All started projects have sufficient financial funds to complete;</p> <p>Penalties are applied to all delays in the implementation of projects according to contract; and</p> <p>A clear segregation of duties will be done to avoid conflicts of interest.</p> | | Partly | |
| 6.2.2 Remunerations | <p>Electronic register of files of civil servants with the necessary data in accordance with Regulation No.03/2011;</p> <p>The files of officials are updated with all relevant data, the workers appraisal carried out on a regular basis, description of works and form of annual leave are</p> | | Partly | |

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|-------------------------------|--|-----|--------|----|
| | settled in the personal files of officers; and Each employee has the employment contract, where the basic salary is determined, otherwise it will be removed from payroll. | | | |
| 6.2.3 Subsidies and Transfers | Approval of internal regulation that will determine clear criterias and procedures for allocation of subsidies and transfers;, and Each beneficiary is completed with documentation and report to relevant Departments of the Municipality on expenditures of funds according to the request and projects offered. | | | No |
| 6.3 Assets | A comprehensive registration of property, buildings, and equipments is made and the same are recorded and disclosed in the next year AFS; and Regular physical counting is carried out in order to ensure the existence of assets and reconcile the counting results with the accounting records and assets register. | | | No |
| 7.1 Internal control system | The current internal control system is reviewed and, where failures are identified, the specific policies and procedures are compiled in order to improve controls. | | Partly | |
| 7.2 Internal audit | The internal audit function is strengthened, the audit committee is more active and audit recommendations are implemented; and | Yes | | |

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|---|---|--|--|----|
| | The internal audit will follow more the actual year processes rather than the past years', and will focus on high risk areas, such as revenues, assets and procurement. | | | |
| 8. Overall conclusion on the management of Prizren Municipality | The entire staff of the municipality together with the managers understands the relevance of laws relating to the framework of PIFC and a number of obligatory policy documents, manuals and Treasury regulations, FMC manual procedures and government's administrative instructions; and In particular, FMC procedures should be made clear to all, and followed by all. | | | No |