



REPUBLIC OF KOSOVA
OFFICE OF THE AUDITOR GENERAL

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

Prishtina, June 2014

The Office of the Auditor General (OAG) undertakes both Regularity and Performance Audits. The Auditor General Lage Olofsson is the head of the OAG which employs around 145 staff. The Auditor General and the OAG shall be independent and certifies around 90 Annual Financial Statements each year, while undertaking other forms of audits.

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

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

The Auditor General has decided on the audit opinion and report on the Annual Financial Statements of Municipality of Rahovec 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 Blerina Krasniqi (Team Leader), Ardita Jetullahu and Elvir Krasniqi.

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Executive Summary

Introduction

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

The examination of the 2013 Annual Financial Statements was undertaken in accordance with the internationally recognised Public Sector Auditing Standards. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated 21/10/2013.

Our audit focus has been on:

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

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

Opinion

Annex I explains the different types of Opinions applied by the Office of the Auditor General. The Auditor General's opinion is:

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

As an *Emphasis of Matter* the Registry of Fixed Assets is still not complete and accurate, given that non-capital asset register was understated by €363,245. In addition, the Municipality misclassified expenditures amounted to €106,563 where from the capital investments code payments were made for subsidies (€29,980) and goods and services (€76,583). Fixed asset register and economic misclassification of expenditures does not affect any of the two Annual Financial Statements (Cash Receipts and Payments and Comparison of Budget and Actual Amounts) in line with IPSAS Cash based accounting. **(ISSAI 200 Unmodified Opinion with an Emphasis of Matter).**

Overall Conclusion

Our overall conclusion based on the detailed sections of this report is that:

The management of Municipality designed an internal control system, but these controls were not operational in some key areas of financial management. These controls should be continuously monitored in order to ensure that they are properly functioning. In the following we presented the areas in which shortcomings were noticed:

- While the Annual Financial Statements addressed the majority of presentational requirements there were a number of omissions and inaccuracies. Some have been amended in the final version of the Annual Financial Statements but management chose to leave some items unadjusted, when it comes to full presentation of assets.
- Most of the recommendations from 2012 and previous years have not yet been implemented. This will result in non-function of internal controls and poor value for money;
- Lack of a complete assets register, reflects weaknesses in controls implemented by the management to confirm the completeness and accuracy of assets; and
- Our assessment of financial management and control has identified that although we have been able to take assurance from the effective operation of management controls in a number of account areas, some significant weaknesses exist in important areas of activity. This particularly applies in planning and low level of revenue collection, procurement, where contracts have been improperly entered into and poorly managed; subsidies not given in accordance with internal regulation and which had no supporting documentation, outstanding liabilities were not reported

monthly, quality of IAU reports was not good and Audit Committee was not operational.

Our key recommendations to the Mayor are as follows:

The Mayor should ensure that:

- 2014 Annual Financial Statements Production Process formally incorporates management review of the draft account with specific focus on areas considered of high risk of error and/or areas where errors have been identified in previous years;
- A revised action plan clearly sets out a timetable for addressing the recommendations made by the Office of the Auditor General with accountable staff members identified and initial focus on those areas of greatest significance;
- Revenue collection obstacles are identified and a concrete plan is established which would increase the level of revenue collection;
- A detailed assessment of Procurement processes and controls is implemented to determine why weaknesses continue to occur and identify actions to be implemented to address these weaknesses;
- All subsidies are given based on planning and based on decisions of competent bodies, as required by an internal regulation. The process should be transparent and subsidies are given only based on adequate criteria, supported by a detailed conceptual plan, in order to reduce the possibility of allocating funds for purposes other than those intended;
- Municipality's liabilities are reported on monthly basis and in accordance with requirements of the Financial Regulation no. 02/2013 on Outstanding Liabilities; and
- Future Internal Audit activities are oriented towards development and implementation of a risk-based audit strategy that is focused on the current year; and
- The work of the Audit Committee gets operational.

Management's Response - 2013 audit

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

1 Audit Scope and methodology

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

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

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

The following sections provide a more detailed summary of our audit finding with emphasis on observations and recommendations in each area of review.

For completeness we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

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

Medium Priority - issues which may not result in a material weakness but where action will also offer the potential for improvements to the efficiency and effectiveness of internal controls.

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

2 Annual Financial Statements and Other External Reporting Obligations

Overall Conclusion

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

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

2.1 Audit Opinion

Unmodified Opinion¹ with an Emphasis of Matter

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

As an *Emphasis of Matter* the Registry of Fixed Assets is still not complete and accurate, given that non-capital asset register was understated by €363,245. In addition, the Municipality misclassified expenditures amounted to €106,563 where from the capital investments code payments were made for subsidies (€29,980) and goods and services (€76,583). Fixed asset register and economic misclassification of expenditures does not affect any of the two Annual Financial Statements (Cash Receipts and Payments and Comparison of Budget and Actual Amounts) in line with IPSAS Cash based accounting. **(ISSAI 200 Unmodified Opinion with an Emphasis of Matter).**

¹ The term “Unmodified Opinion” is equivalent to the term, “unqualified opinion” used in our previous year’s reports. The new wording is in accordance with the new INTOSAI audit standards (ISSAI 200). For more information refer to Annex 1.

2.2 Significant risks to the Annual Financial Statements

Description

Our Audit Planning Memorandum dated 21/10/2013 identified significant risks to the AFS related to the completeness of assets and related to the presentation of Third Party Payments. These are risks of material misstatement that may result in a modified opinion including an Emphasis of Matter.

The risk of material misstatements that we have identified relating to the completeness of assets and presentation of third party payments has occurred as the management had not taken actions to address encountered risks.

Identified risk

Issue 1 - Failure to present third party payments in the AFS of the Municipality

Finding

During our interim audit, we reviewed management's controls and associated guidance applied to proper presentation of third party payments in the AFS and provided advice to enhance these as appropriate. The identified risk has materialised as the management has not managed to make necessary corrections in internal control and we confirmed that the values of third party payments presented in the AFS are materially inaccurate. However, after our suggestions for correction, the Municipality addressed this problem and presented true value of these payments in the final AFS.

Recommendation 1 High Priority - The Mayor should analyse the reasons for failing to fairly present third party payments in the initial AFS, and identify appropriate actions to address these control weaknesses in order to enable their fair and true presentation in 2014.

Identified Risk

Issue 2 - Assets owned by Municipality are not identified and registered appropriately

Finding

We have assessed the controls implemented by management to prove the completeness of asset records in the context of capital expenditure in 2013 and in previous years. In our interim memorandum we provided advice to management on the action required to ensure that the assets figure in the AFS was correct. However, the risk identified has materialised because management has been unable to implement necessary improvements in internal control and we noticed that current year purchases such as: stoves for Municipality's schools

in the amount of €11,790, restoration of grocery market in the amount of €15,000, and stocks in the amount of €9,670 were not presented in the Municipality's assets register. The register of non-capital assets was undervalued by €363,245. The stocks register did not contain stocks of education sector and of health sector within the Municipality. Non-capital assets and stocks are processed in the e-assets register in a systematic manner. From this, we have confirmed that assets values recorded in the AFS are materially incorrect.

Recommendation 2 High Priority - The Mayor should analyse the reasons for incomplete and unfair presentation of assets in the AFS for 2013 and identify the action required to address these controls weaknesses to enable a true and fair presentation of Assets in the 2014 AFS.

2.3 Compliance with AFS reporting requirements

Description

The AFS are required to comply with a specified reporting framework. We considered and we haven't any issues to raise about:

- Compliance with FR no. 03/2014;
- Requirements of LPFMA no. 03/ L-048;
- AFS were submitted within the timeframe and to the Ministry of Finance (MoF);
- AFS are signed by the CAO (Mayor) and the CFO;
- AFS were submitted in Albanian and Serbian;
- AFS were prepared in hard and electronic copy; and
- Municipality submitted regular quarterly reports to the Municipal Assembly and one copy to the Minister of MoF during 2013.

Besides compliance, we have identified some shortcomings in presentation of information. A number of financial adjustments were required to the draft AFS and we have also made a number of other suggestions to improve them.

After our suggestions, some corrections were made to the AFS and this is shown by the section 2.2 of this report, whereby were corrected payments from third parties. However, the Municipality did not correct the following errors:

Issue 3 – AFS preparation process - High Priority

Finding The value of assets presented in Note 30 and 31 was not accurate. The register of non-capital assets was understated by €363,245.

In addition, the Municipality misclassified expenditures in the economic category Capital Investments in the amount of €106,563. From this category, the amount of €29,980 was paid for subsidies and €76,583 for goods and services.

Risk Incorrect presentation of financial statements and errors in the amounts recorded lead to misinterpretation of Municipality's financial position and have potential negative impact on the accuracy of future budget requests.

Recommendation 3 The Mayor should identify appropriate actions to address these control weaknesses in order to enable a fair and true presentation of data in 2014.

2.4 Compliance with other external reporting requirements

Description

The Municipality met the following external reporting obligations other than producing AFS:

- Budget request;
- Quarterly reports including nine month financial statements in time;
- Operational (performance) reports; and
- Draft and final procurement plan in time.

Recommendations

We have no recommendations in this area.

3 Prior Year Recommendations

Overall Conclusion

The Municipality, although with delay and not within the legal deadline, submitted a plan for addressing previous year recommendations to the OAG.

Despite the fact that an action plan was drafted, most of the recommendations given in 2012 were not implemented, thus resulting in same weaknesses being repeated in the following year.

Description

Our Audit Report on the 2012 AFS for the Municipality of Rahovec resulted in 14 recommendations.

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

Issue 4 - Addressing Prior Year Audit Recommendations - High Priority

Finding Only a proportion of prior year recommendations have been addressed because the Municipality has not implemented any formal process to manage and monitor the way that the AG's recommendations are implemented.

Risk Delays in addressing recommendations lead to the risk for continuous existence of same weaknesses and problems in key controls over relevant recommendations. Due to this, the revenue collection and assets management was inefficient, and there was poor value for money spent.

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

4 Financial Management and Control

4.1 Overall Conclusion

Our audit approach is focused on understanding and evaluating the actions taken by management to secure effective financial management and control and the results of this action. For individual financial systems we seek to identify the level at which actual controls operate. We consider that controls are well designed, have been implemented as planned and operate effectively. This requires an assessment of structures, processes and accountability lines introduced by management including the role undertaken by Internal Audit and Audit Committees.

We also considered Municipality's self-assessment undertaken in the context of Public Financial management (PFM) both in terms of PEFA assessments and PIFC self-assessment.

We found that most of controls implemented by the Municipality require further improvement. Controls over revenue collection and a range of expenditure areas require further enhancement to prevent Municipality from suffering financial loss, poor value for money and ineffective project management. The main areas where most improvements are required are: Budget Planning, Revenues, Procurement, Subsidies, and Outstanding Liabilities.

4.2 Good Governance

Description

The Municipality's internal financial reporting is regulated through the applicable legal framework. However, weaknesses in high-level controls identified suggest that the management is not receiving proper information giving a base for an active approach to address these issues, or the management is not taking appropriate actions to do this.

Issue 5 - Weaknesses in high level management controls

Finding Our review of management controls applied to the Municipality's key financial system highlighted a poor financial reporting of the budget and expenses to the senior management. This is because the format of management reports does not provide explanations on the budget funds available against creation of obligations. Due to this, the Municipality entered into many financial obligations and contractual agreements.

Rizik Weaknesses regarding functioning of management controls reduce management's ability to actively manage the operations of the Municipality and undermine effective budgetary control. This may result in unplanned over spend and failure to meet governance objectives.

Recommendation 5 The Mayor should carry out a review to determine the format of reporting to senior management to support effective business management and introduce appropriate solutions.

4.3 Budget Planning and Execution

Description

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

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

Description	Initial Budget	Final Budget ²	2013 Outturn	2012 Outturn	2011 Outturn
Sources of Funds	9,774,525	10,384,259	10,067,841	10,276,518	9,965,837
Government Grant - Budget	8,824,525	9,174,525	9,148,203	9,061,614	8,758,131
Carried forward from previous year ³ -	-	194,162	188,362	333,620	305,977
Own Source Revenues ⁴	950,000	950,000	680,000	615,107	633,904
Domestic Donations	-	32	-	-	2,380
External Donations	-	65,540	51,277	266,177	265,445

The final budget, compared with the initial budget, was higher by €609,734. This increase is a result of External and Domestic Donations in the amount of €65,572 and revenues carried forward from the previous year in the amount of €194,162, and of €350,000 were appropriated under budget review.

In 2013, Municipality used 97% of the final budget. Explanations on spending by economic category are detailed below.

² Final budget - the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

³ Own Source Revenues unspent in previous year carried forward into the current year.

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

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

Description	Initial Budget	Final Budget	2013 Outturn	2012 Outturn	2011 Outturn
Spending of funds broken down by economic categories	9,774,525	10,384,259	10,067,841	10,276,518	9,965,837
Wages and Salaries	5,365,372	5,365,576	5,330,305	5,361,722	5,151,332
Goods and Services	733,893	726,847	693,593	939,328	876,762
Utilities	257,260	271,260	271,208	292,565	268,618
Subsidies and Transfers	100,000	100,051	93,845	94,141	123,759
Capital Investments	3,318,000	3,920,525	3,678,890	3,588,762	3,545,366

Explanations for changes in budget categories are given below:

- The final budget for Capital Investments increased by €602,525 compared to the initial budget. This increase occurred due to revenues in the amount of €194,162 were carried forward, External Donations in the amount of €58,363 and the amount of €350,000 was appropriated to support a two-year project which commenced in 2012 for construction (asphalting) of road Fortese – Celine. The project is still ongoing and 90% of completed works were paid so far;
- The budget for Goods and Services was reduced by €7,046. This amount was allocated for Utilities. The reason behind higher initial budget planning in this category was because fuel costs were estimated to be higher. But, this did not materialise and expenditures during this year were 95% of the final budget.
- The increase of budget for Utilities by €14,000 is as a result of funds transferred from the category of Goods and Services and the rest as a result of budget review. This was done with aim to cover utilities, which turned out to be higher than forecasts and plans of the Municipality under initial budget for this category,
- The Municipality during 2013 also received grants from external donors i.e. the European Commission Office in Kosovo in the amount of €65,540, which were allocated for Capital Investments, specifically for implementation of the project “Vineyard vines and development of wine in southern Kosovo”. The budget execution during 2013 for these donations was only 78% of the final budget,
- Each year Own Source Revenues are underspent as a direct result of budget underspending, given that Own Source Revenues are the last source of funding used. In 2014, the carried forward value of Own Source Revenues is €162,000.

Table 3 Municipality own source revenues budgeted and collected in 2013 (in €)

Description	Initial Budget	Final Budget	2013 Receipts	2012 Receipts	2011 Receipts
Own source revenues	950,000	950,000	842,364	800,404	888,000

The budget foreseen for collection of Own Source Revenues was implemented approximately by 89%. The Municipality does not take into account the trend of receipts from previous years e.g. the degree of receipts in 2011 was higher than in the last two years.

On the other hand, debts to the Municipality exceeded 2.2 million, which is very significant amount for the Municipality and the balance of receivables is steadily increasing.

Issue 6 - Budget Execution - High Priority

Finding Despite the high level of budget execution, planning of capital investments budget was not appropriate. Excluding uncollected Own Source Revenues, over €130,000 from this category were not spent, while at the end of the year, it reported large amounts of outstanding liabilities.

Risk Failure to plan the budget adequately could result in not meeting the Municipality's objectives and financing current liabilities from budgets of the following year.

Recommendation 6 The Mayor should ensure that the process of budget preparation is followed by a re-assessment of the process, and planning is done based on reasonable and realistic parameters.

4.4 Own Source Revenues

Description

The Municipality established some controls over revenues. However, there is a need for further improvement, especially when it comes to issuing and application of adequate policies and mechanisms for collecting previous years debts from property tax, rents and other debts. Furthermore, stricter controls are required for monthly reconciliations between departments and the revenue officer, renewal of expired contracts for properties rented currently by the Municipality, amending the legislation in use on issuance of construction licenses and using electronic systems when processing administrative fees.

Revenues collected by the Municipality of Rahovec in 2013 were in the amount of €842,364. Sources of these revenues were revenues from property tax, construction licenses, administrative fees, etc.

Issue 7 - Improper planning and collection of revenues - High Priority

Finding

The Municipality for 2013 planned to collect the value of €220,000 from tax, while it managed to collect €284,945. This shows that the annual plan was exceeded. Taking into account the prior year where revenues collected were in the amount of €265,460, this indicates that the planning was not good, as the value planned for 2013 is much lower than the revenues collected in the prior year. The amount of debts accumulated through the years from property tax amounts to €1,391,589. The Municipality does not have a plan or a strategy for collection of these debts.

The Municipality planned to collect €47,000 from construction licenses, while it collected €24,185 or 51% of revenues planned.

The invoiced value of rented out facilities was in the amount of €47,246, while the Municipality managed to collect €38,248 or 81% of the invoiced amount. The amount of debts accumulated through the years from renting out municipal facilities is in the amount of €139,525. In the leasing agreements with companies: "NT Ganex" we noticed that this company did not make any payments in 2013, while it owes €53,377; the company "NT Frigo Star" paid only €3,000, while its debt was in the amount of €15,560; the Company "NT Xeni Comerc" which this year paid only €1,512, while its debts amount to €8,127; the company "Sh.p.k Modern" did not make any payments for this year, while its debts are in the amount of €6,300.

Risk Improper planning and collection policies could risk maximisation of revenues and meeting of objectives foreseen for this period.

Recommendation 7 The Mayor should ensure that budgeting of revenues is done based on proper planning and realistic parameters. In addition, obstacles regarding revenue collection should be identified and a concrete plan is established which would increase revenue collection. The management should take immediate action regarding the contracts on rented properties and collection of remaining debts, otherwise the contracts should be terminated and use of public property stopped.

Issue 8 - Incorrect calculations, and failure to adhere to law when issuing construction licenses - High Priority

Finding In two cases, the Municipality made incorrect calculations when determining the fees for construction license beneficiaries, resulting in a smaller fee of €490 from what was foreseen in the Municipal Regulation on taxes, fees, and charges.

In addition, the Municipality, when issuing construction licenses, does not apply the new Law on Construction no. 04/L-110, approved in May 2013, it continues to apply the internal regulation.

Risk In cases when smaller fees are applied other than those foreseen when calculating fees for construction licenses results in financial losses for the Municipality.

Recommendation 8 The Mayor should ensure that all construction license beneficiaries are charged with exact amounts and in accordance with The Law on Construction.

Issue 9 - Shortcomings in contracts and invoicing when renting Municipal facilities - High Priority

Finding In 2008, the Municipality entered into a lease contract for municipal property with "NT Ganex" and the same continues to use municipal property even though it does not have a contract covering the entire 2013.

In 2013, the Municipality signed a four-year agreement renting out a cafeteria in the city park without specifying who will be charged with utilities for this cafeteria when it becomes operational. As a result, the Municipality covered all these costs for 2013 which were in the amount of €5,745, while the annual rent payment from the renter was in the amount of €2,460, thus incurring a financial loss to the Municipality in the amount of €3,285, instead of benefiting from leasing contract.

Furthermore, not all users of municipal properties were charged with invoices on monthly basis.

Risk Lack of contracts on properties that Municipality rents out increases the risks that these debts are not collected. Ambiguous lease agreements are a risk for continuous financial losses to the Municipality.

Recommendation 9 The Mayor should ensure that the expired contracts are renewed and invoicing of entities is done on monthly basis. Furthermore, the Municipality should clarify all commercial agreements and terminate contracts which are not favourable for the Municipality.

Issue 10 – Shortcomings when processing and reporting revenues - High Priority

Finding The Municipality did not install the new system for processing payments and administrative fees. The purpose of this system is that all payments under €10 made by citizens for services provided by the Municipality are recorded in a database, thus removing receipts.

Monthly reconciliations between the revenue officer and municipal departments are not regularly done, which are required to avoid potential discrepancies and ensure efficiency in revenue reporting.

Risk Failure to use the system for processing administrative fees payments and failure to make monthly reconciliations between the revenues officer and municipal departments are a risk to the accuracy and completeness of revenue reporting.

Recommendation 10 The Mayor should ensure that processing of administrative fees is made through the electronic system and monthly reconciliations are made between the relevant departments and revenues officer. This process should be monitored on regular basis.

4.5 Expenditures

4.5.1 Procurement

Description

The purchases made through procurement procedures for 2013 were in the amount of €6,182,115. A number of contracts were framework contracts and their value varied, as they were based on price per unit and supplies may increase or decrease.

We have tested 24 sample units amounted to €3,922,889 to determine how procedures were developed, and 59 sample units amounted to €1,609,079. Our findings are described in the following of this report.

We have analysed whether capital investment projects were recorded in the Public Investments Program (PIP) and in the Medium-Term Expenditure Framework. In addition, we have reviewed whether there were changes during the year relating to planned projects. We noticed weaknesses in PIP management by the Municipality and we present them in the following.

Issue 11 - Systematic weaknesses in procurement - High Priority

Finding In many cases, the Municipality did not comply with financial and procurement rules:

In twelve cases, the Municipality entered into liabilities exceeding budget allocations for certain projects. The amount of budget allocations for these projects for three years was in the amount of €2,213,266. The value of contracts entered into for implementation of these projects was in the amount of €6,167,076. Budget deficits for these projects amount to €3,953,810;

The Municipality does not maintain or update the PIP. In 14 cases, we noticed that the Municipality failed to make necessary updates in PIP, when changing the value of initial contract compared to the budgeted one. Four projects were not recorded in the PIP, and no reporting was done on the progress of these projects;

In four cases, the Municipality awarded the contract to ineligible operators who have not met the criteria set out in the Tender Dossier;

In four contracts, the performance security did not cover the contract implementation period;

In six cases, Tender Dossier foresaw performance security in the amount of €1,000 and not the value of 3% or maximum 5% of the estimated project value, as required under the legal regulations; and

The Municipality is obligated to notify unsuccessful Economic Operator (EO) in writing, explaining the reasons for the decision taken. The Municipality failed to notify EOs in 14 cases.

Risk Entering into contracts without sufficient funds results in obligations and impacts the budget and next year objectives. Failure to update the PIP will reduce effective implementation of capital expenditure plans. Failure to notify unsuccessful EOs risks transparency of the process. Failure to extend performance security deadlines risks completion of projects in line with the contract.

Recommendation 11 The Mayor should implement an internal review to determine why procurement requirements are not implemented in all procurement cases, and to apply more controls to ensure that systemic weaknesses identified are addressed.

Issue 12 – Procurement’s non-systemic weaknesses - High Priority

Finding

The Municipality paid the amount of €3,296 for “Disinfection of selective areas, regions affected by the hemorrhagic fever” in disagreement with following procurement procedures. Selection of winning company was done through signing of a Memorandum of Understanding between the mayor and the relevant company.

The Mayor took a decision to allow financial means to the EO Grafix in the amount of €4,500 to cover costs for organising a folklore festival, by disregarding procurement procedures.

The Municipality purchased six laptops for the needs of members of Policy and Finance Committee without applying procurement procedures. This purchase was done based on a memorandum of understanding signed between the Director of Budget and Finance and the “NTP Sinkopa” in the amount of €3,127. In addition, the agreement did not determine specifications of laptops, quantity, and other delivery requirements.

In the contract “Construction of roads with concrete cobblestones in the village Krushe e Madhe” in the amount of €210,538, the Municipality awarded the contract to the EO which in its Dossier presented a subcontractor with participation of 66% of the value bided. This is not in line with the Law on Public Procurement (LPP), which foresees that maximum subcontracted value may be up to 40% of the contract value.

Risk

Avoidance of procurement procedures risks the quality of works or goods received. Paying goods with higher prices than the contracted bid increases the risk for significant financial losses for the Municipality.

Recommendation 12 The Mayor should review why procurement requirements were not consistently applied in the abovementioned cases and enhance controls ensuring that such situation is not repeated.

4.5.2 Remunerations (Wages and Salaries)

Description

Wages and Salaries are paid through a centralised system. Controls operated locally by the Municipality relate to a) authorisation of payroll list; b) verification of possible changes; and c) budget review for this category and reconciliations with the treasury.

We have tested 33 samples to verify whether the payroll system and the payroll list, recruitment procedures and regularity of personnel files reconcile. We have not found any irregularities that need to be reported concerning this.

Recommendations

We have no recommendations in this area.

4.5.3 Subsidies and Transfers

Description

The Municipality for 2013 planned the amount of €100,051 for subsidies and transfers and spent €93,845.

The Municipality during the year drafted an internal regulation on granting of subsidies, but most of subsidies were given before being approved. Due to this, subsidies were granted without established criteria, thus jeopardising the purpose for which they were intended.

Issue 13 – Subsidies given without supporting documentation - High Priority

Finding The Municipality had given 81 student scholarships of €40,500 that were not planned with the appropriations of Education Department. These funds were received from Health Department. For this subsidy no decision was taken by the mayor or the Assembly.

The Mayor had taken the decision to give €5,000 support to the festival “Nine Eleven”. The beneficiary had not submitted reports and evidence that this event took place, and there was no monitoring report on this activity by the Municipality.

Subsidies were also given to the Football Club “Rahoveci” in the amount of €1,500, to the Cultural Association “Anadrinia” for organising the festival “Anadrinia Jehon 2013” in the amount of €2,000, and to Cultural Association “Bajram Curri” from Krusha e Madhe in the amount of €1,500. Subsidies were given without any supporting documentation, such as: the registration certificate, clear reasoning of applicants’ requests. The annual information on activities and financial turnover was also missing as required under the internal regulation. In addition, the Municipality did not monitor activities of any of the beneficiaries.

Risk Giving subsidies without decisions of competent authorities, disregarding internal regulation criteria and subsidising students without public competition, are some of the shortcomings that risk the transparency of the process and funds being spent for purposes other than those intended.

Recommendation 13 The Mayor should ensure that all subsidies are given based on planning and according to decisions of the competent authorities, as foreseen by the internal regulations. The process should become transparent and subsidies given only based on adequate criteria, followed with a detailed conceptual plan with the intent to diminish the possibility of funds being spent for purposes other than those intended.

4.6 Assets and liabilities

4.6.1 Capital and non capital assets

Description

During our audit we noticed a commitment by the Municipality to record its assets in the KFMIS. The value of capital assets in previous year was €88,750,211, while the value of assets at the end of 2013 increased to €89,129,220. Despite these efforts, the Municipality does not have sufficient controls over its capital assets. Lack of controls by the Municipality were also noticed over management and recording of assets under €1,000.

In addition to assets, issues raised in this chapter, the data concerning their completeness are described in Chapter 2.2 - Significant risks in the AFS.

Issue 14 - Weakness in assets management - High Priority

Finding The Municipality during 2013 did not establish Asset inventory and Evaluation Committees, as required under the Regulation 02/2013 on Management of Non-financial Assets.

Risk Lack of controls over assets management and lack of recording of assets in line with the rules may lead to loss, misuse and their unauthorised use.

Recommendation 14 The Mayor should ensure that the Inventory and Evaluation Committees complete their work and report timely. Assets management officer should record and maintain assets register under the Regulation 02/2013 on Management of Non-Financial Assets.

4.6.2 Handling of debts

Description

The statement of outstanding liabilities to suppliers at the end of 2013 was €2,202,988. Compared to 2012 where liabilities were in the amount of €56,807, the increase this year was by over 2.1 million. The high amount of outstanding liabilities is mainly because the Municipality has entered into contracts without sufficient budget to implement these contracts. These liabilities are transferred to be paid in 2014. The problem that the Municipality has with liabilities is handled in Chapter 4.5.1 of this report.

Issue 15 – Failure to report liabilities - High Priority

Finding The Municipality does not submit regular monthly reports to the MoF on outstanding liabilities, as required under the Financial Rule on outstanding liabilities.

Risk Failure to report liabilities regularly and timely is a risk for the Municipality as it may not be aware of its liabilities on time and enter into further liabilities, thus risking the budget and meeting objectives of the next year.

Recommendation 15 The Mayor should ensure that liabilities of the Municipality are reported on regular monthly basis and in accordance with requirements of Financial Rule on Outstanding Liabilities.

4.7 Internal Audit System

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 addition we review actions taken by senior management as a result of the work carried out by internal audit and the audit committee.

The Internal Audit Unit (IAU) has an annual audit plan. In 2013 it carried out 15 audits as foreseen. Seven out of fifteen reports carried out (47% of the IAU work) focused and covered 2012. As the reports have been in great number but the quality in terms of identifying and handling certain issues was missing. Putting the Audit Committee in place is necessary to support the IAU in their work and assist the Management to strengthen Municipality's internal controls.

Issue 16 - Lack of quality of IAU reports and inoperable Audit Committee - High Priority

Finding The IAU reports were deficient when it comes to identifying and addressing issues that the Municipality faced. The IAU did not properly address problems such as outstanding liabilities, procurement, subsidies, etc. to enable the management preventing shortcomings encountered throughout the year. The Municipality established an Audit Committee but it was not operational during 2013.

Risk Lack of quality in IAU reports and the greater focus on the work of last year, risks preventing shortcomings. Having a non-functional Audit Committee risks effective operation of the IAU.

Recommendation 16 The Mayor should ensure that IAU in the future should be oriented towards development and implementation of the risk-based audit strategy focused on the current year. This would give assurance to the management on effectiveness of internal control systems. The Audit Committee should be operational.

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

(extract from ISSAI 200)

Form of opinion

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

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

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

Modifications to the opinion in the auditor's report

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

Determining the type of modification to the auditor's opinion

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

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

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

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

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

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

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 1705¹⁹ provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

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

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

158. An Emphasis of Matter paragraph should:

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

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

Annex II: Prior year recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
2. Financial statements	The Mayor should ensure that systematic plan of financial statements preparation incorporates the requirement to include all assets' values. The Mayor needs to monitor the implementation of this requirement.			No measures were taken
3. Prior Year Recommendations	The Mayor should provide an action plan to address the OAG recommendations, which clearly sets a timetable and staff members accountable, with initial focus on areas of major importance.	Yes		
4.4 Revenues	3 The Mayor should have a comprehensive approach on handling revenues in terms of planning, as well as in the establishment of effective mechanisms for achieving planned parameters. Mayor should initiate a reassessment process, where all accounts will be analyzed in terms of age, significant amounts, realistic collection possibilities and the exercise of administrative measures (if necessary).			No measures taken
4.4 Revenues	The Mayor should review these contracts and insist on remaining debt's collection. On the contrary, the contract should be terminated. The management should perform continuous contracts review and should strengthen controls.			No measures taken

4.5.1 Procurement	The Mayor must ensure that the budget will be implemented in accordance with prior approvals and that all expenditures are made from appropriate budget categories. On the contrary, must follow normal procedures for budget transfers from one economic category to another. Also, procurement procedures and beneficiaries reporting must be applied.			No measures taken
4.5.1 Procurement	The Mayor must ensure that procurement service manages the procurement process based on legal requirements, across all phases, by complying with all criteria preset in the tender dossier.			No measures taken
4.5.1 Procurement	The Mayor should ensure that all eliminated bidders, are timely informed and according to legislation prescribed manners, even by explaining their rights and appeal possibilities. Notifying EOs is a legal requirement, and as such, should implement by the procurement service.			
4.5.1 Procurement	The Mayor should ensure the establishment of evaluation committees within defined deadlines, immediately after bid opening process within specified time limits.	Yes		
4.5.2 Remunerations (Wages and Salaries)	The Mayor through his mechanisms should make a systematic review of personnel files to ensure that all documentation and necessary changes are included, within the specified time period. The Mayor should review the case if the payments were based.	Yes		
4.5.2 Remunerations (Wages and Salaries)	The Mayor should ensure that in case of staffs recruitment, the process is objective and transparent, aiming to hire qualitative and convenient staff for the Municipality.	Yes		

4.5.3 Subsidies and Transfers	The Mayor should ensure that it will adopt a rule which clearly specifies the criteria, procedures and Subsidy sources.	Yes		
4.5.3 Subsidies and Transfers	The Mayor should ensure the establishment of appropriate procedures and controls on subsidy expenditures in line with initial appropriations.			
4.6.1 Capital and non capital assets	13 The Mayor should initiate a systematic assets registration process The Mayor should ensure that as soon as possible establishes a committee which would fairly assess and correctly register all Municipality owned fixed assets, and monitors the evaluation results.			No measures taken
5 Internal Audit System	Mayor should draft an action plan and determine how the IAU findings and recommendations will be addressed by all management levels. IAU must focus more on current year audits.			No measures taken