



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

Document No: 22.13.1-2015-08

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

Prishtina, june 2016

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

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

The reports produced by the Office of the Auditor General directly promote accountability as they provide a base for holding managers' of individual budget organisations to account. We are thus building confidence in the spending of public funds and playing an active role in securing taxpayers' and other stakeholders' interests in enhancing public accountability.

The Auditor General has decided on the audit opinion and report on the Annual Financial Statements of Municipality of 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 Mehmet Muçaj, (Team Leader) and Shpresa Zenelaj, (Team member).

TABLE OF CONTENTS

Executive Summary.....	4
1 Annual Financial Statements and other External Reporting Obligations	7
2 Governance.....	11
3 Financial Management and Control	17
Annex I: Audit Approach and Methodology	29
Annex II Explanation of the different types of opinion applied by the OAG	30
Annex III: Prior Year Recommendations	33

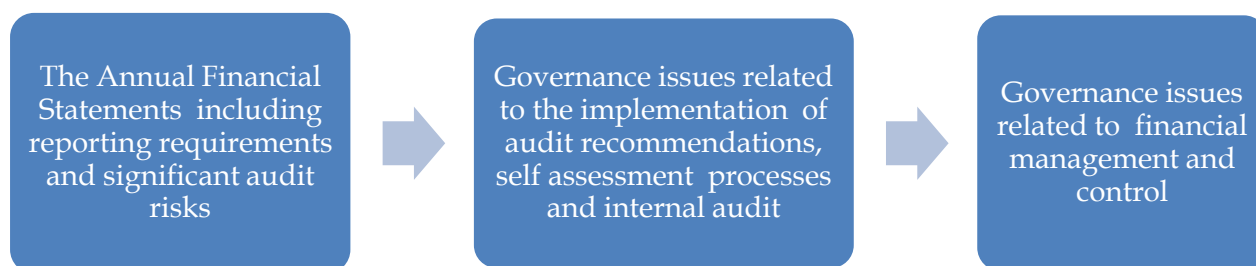
Executive Summary

Introduction

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

The examination of the 2015 annual financial statements was undertaken in accordance with the internationally recognised Public Sector auditing standards (ISSAIs). Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated 18.11.2015.

Our audit focus has been on:



(For more details see Annex 1 of this report)

The level of work undertaken by the Office of the Auditor General to complete the 2015 audit is determined from the quality of internal controls implemented by the Management.

Opinion

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

The Auditor General's opinion is:

“Unmodified Opinion with Emphasis of Matter” because Municipality's assets were understated given that 120 hectare of agriculture land and eight premises of the Municipality were not recorded in the accounting registers and ongoing investments were understated by €352,871.

In addition, the Municipality misclassified making payments from Capital Investments for goods and services, subsidies and transfers, and co-finances which were planned by the budget .

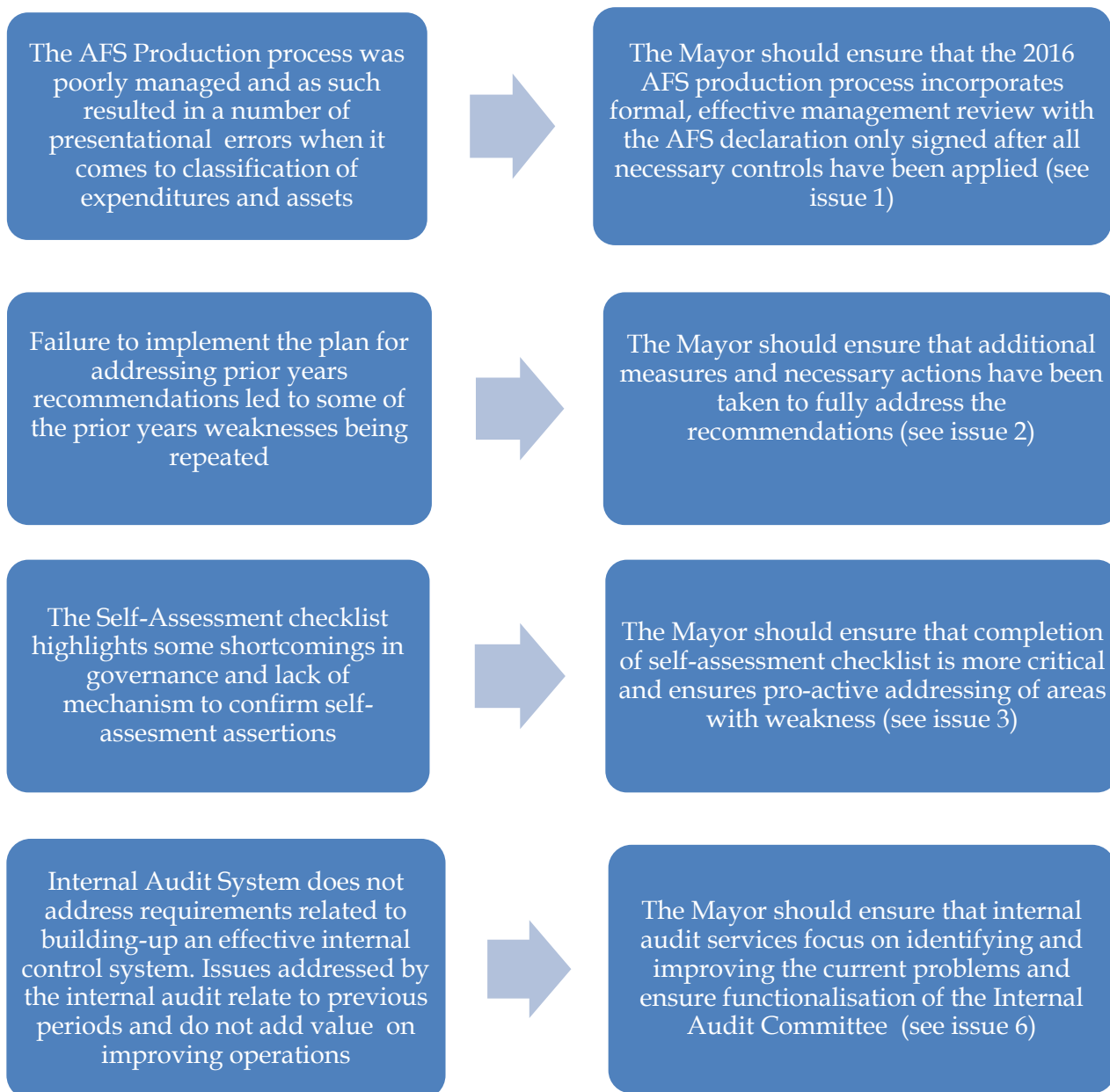
Emphasis of Matter

A complete opinion is detailed in Section 1.2 of this report.

Overall Conclusion

Internal control system in terms of reporting on the current level does not provide assurance that operating and financial activities of the Municipality are carried out effectively, and as such, it needs to have an increased supervision and improvement in some areas.

Our key conclusions and recommendations are:



Systematic weaknesses in procurement are characterised with contracts signed beyond budget allocations and developing procurement procedures outside the plan



The Mayor should ensure that a review is undertaken to determine why Procurement requirements have not been addressed in all procurement cases and exercise more controls to ensure that the identified systematic weaknesses are addressed (see issue 8 and 9)

Management response - audit 2015

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

We take it for granted that the Mayor:

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

1 Annual Financial Statements and other External Reporting Obligations

1.1 Introduction

Our review of the 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 Executive Officer (CEO) and Chief Financial Officer (CFO) when the draft AFS are submitted to the Government.

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

1.2 Audit Opinion

TO: MUNICIPALITY OF RAHOVEC

UNMODIFIED OPINION WITH EMPHASIS OF MATTER

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

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

Basis for Qualified Opinion

We conducted an audit in accordance with International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Annual Financial Statements section of our report. OAG is independent of the Municipality in accordance with the ethical requirements that are relevant to our audit of the annual financial statements of budget organisations in Kosovo and we have

fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the obtained audit evidence is sufficient and appropriate to provide a basis for the qualified opinion.

Emphasis of Matter

We draw your attention to the fact that the Fixed Assets Register does not reflect a complete assets situation because the total value of assets (€52,206,159) did not include 120 hectares of agriculture land and eight premises of the Municipality and that ongoing investments of €352,871 were understated because 16 payments for different projects were recorded in KFMIS Accounting Register as an expense but not as ongoing investments as well.

The Municipality misclassified expenditures by paying €395,732 from Capital Investments, out of which €224,547 for goods and services, €48,351 for subsidies and transfers and €122,834 for salaries based on an Agreement with Caritas Kosova. The reason behind the misclassification was poor budget planning for this category. In addition, €87,000 third party payments were not recorded in KFMIS The Audit Opinion is not modified in respect to these issues.

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

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

The Mayor and Chief Financial Officer are responsible for overseeing the Municipality's financial reporting process.

Auditor's Responsibility for the Audit of the Financial Statements

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

1.3 Significant Audit Risks to the AFS

Description

Our Audit Planning Memorandum dated 18.11.2015 identified three significant risks to the AFS. These are risks of material misstatement which may result in a modification of the opinion or Emphasis of matter. Risks identified relate to third parties, lack of complete asset registry and incorrect classification of expenditures.

Risk of asset recording – The Municipality addressed a recommendation for asset recording, but it did not manage yet to establish a reliable final register. In this sense, the Municipality overstated investments for €85,920 registering payments twice for the same for projects “Construction of roads in the Municipality of Rahovec and sanitation in the village Pastasel” and it understated ongoing investments for €352,871 given that 16 payments for different projects were recorded in KFMIS Accounting Register as an expense but not also as ongoing investments.

The risk of misclassification - We have identified that the management has not taken action to address recommendations regarding the misclassification of expenditures. From the category of capital investments payments in the total amount of €395,732 were made for Goods and Services (€224,547), subsidies and transfers (€48,351) and salary under the agreement with Caritas Kosovo by (€122,834). . It is worth to clarify that the amount of €395,732 was approved with the budget tables for Budget 2015 on capital investments, but the projects presented in the table does not meet the requirements to be treated as capital projects, and errors relate to the initial planning of the municipality and inadequate approvals made by the MoF.

The third significant risk relates to presentation of third party payments, in terms of presentation in AFS has not been materialised because the management following our suggestions (until we were on the field) has taken appropriate actions and recorded €87,000 from third party payments. However, those records were not processed in KFMIS, as required under the procedures for recording donor designated grants in Kosovo.

1.4 Compliance with AFS and other reporting requirements

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

- Compliance with Financial Rule MF no. 03/2013;
- Requirements of LPFMA no. 03/L-048 (as amended and supplemented);
- Compliance with budget requirements;
- Quarterly reports sent to the Municipal Assembly; and
- Procurement Plan

In the context of the AFS we have not found any irregularities.

Initially, draft AFS contained some material errors. Following our recommendation, the parts where it was possible to intervene have been adjusted but statements still contain some errors such as:

Issue 1 - Errors in AFS - High Priority

The Municipality did not record third party payments of €87,000;

From the category of capital investments payments were made in the total amount of €395,732 for Goods and Services (€224,547), Subsidies and Transfers (€48,351) and salaries under the cooperation agreement with Caritas Kosovo amounted to €122,834; and

In Article 16 Disclosure of Assets – the Municipality presented municipal assets in the amount of €52,206,159, while we identified that this amount did not include 120 hectares of agricultural land, 8 municipal facilities and 16 payments for capital investments which were made in 2015 in the amount of €352,871.

1.5 Recommendations

Recommendation 1 High Priority – The Mayor should ensure that effective processes are in place to confirm that the 2016 AFS production plan formally addresses all issues raised, including significant risks on misclassification of expenditures and disclosure of assets. This also should include the management review of the draft AFS with specific focus on high risk areas and areas where errors have been identified.

2 Governance

2.1 Introduction

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

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

Our reviews have identified several shortcomings in the field of good governance which are outlined below:

2.2 Overall Governance Conclusion

There are number of governance weaknesses within the Municipality particularly related to risk management, implementing strategic objectives and the quality of management reporting. The self-assessment checklist completed by the Municipality only partially recognises this situation with some positive comments about existing arrangements not sufficiently evidence based. Other arrangements which would support the development of governance such as an effective response to audit recommendations and the operation of a high quality internal audit unit are not in place.

2.3 Prior Year Recommendations

Our Audit Report on the 2014 AFS resulted in 16 key recommendations. The Municipality prepared an Action Plan stating how all recommendations will be implemented. We appreciate the fact that the management still needs to strengthen the managers' accountability process when it comes to implementation of recommendations.

It should be noted that the audit report on AFS 2014 was discussed at the Municipal Assembly on 31.08.2015 which has an impact on enhancing the transparency and more critical review of municipal activities.

By the end of our audit for 2015, four (4) recommendations have been implemented, five (5) were addressed and are under implementation and seven (7) were not addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex III.

Issue 2 - Implementing Prior Year Recommendations - High Priority

Finding The Municipality implemented only a proportion of prior year recommendations. This because no formal process for their addressing was followed and the process of implementing recommendations according to Action Plan was not fully monitored.

Risk The repeated weaknesses of management in financial systems and other areas of the activity resulted in:

- Capital projects not being planned properly, leading the Municipality to enter into obligations more than the budget appropriations;
- The incorrect classification of expenditures into inadequate economic categories;
- Avoidance in some cases from the standard requirements of the procurement process; and
- Inadequate performance by the IAU and deficient activity of the Internal Audit Committee.

Recommendation 2 The Mayor should strengthen control measures and accountability against those persons charged to fully address the recommendations that the actions defined in the Action Plan are implemented, particularly in high risk identified areas and within the timetable set.

2.4 FMC Self-Assessment Checklist

The Ministry of Finance has produced a detailed self-assessment checklist for Budget Organisations to support effective governance arrangements. For all audits we undertake we have tested the quality of self-assessment questionnaires submitted to the MoF. We have summarised our findings for the Municipality below. This is not intended to give a commentary on the quality of the whole self-assessment questionnaire submission but will provide a ‘snapshot’ across a number of key questions to support the Ministry of Finance in its attempts to increase the effectiveness of the process and develop FMC system in general.

Issue 3 –Self-Assessment Checklist – High Priority

Finding As part of our audit we have considered several key questions related to the five components of the self-assessment questionnaire. For the questions considered we found that:

1. The Municipality has a strategy adopted since 2009 without any time limit covered. We were not provided with any evidence that the strategy is discussed with the managers of budget organisations and third parties outside the Municipality such as: stakeholders, civil society, citizens etc. Further on, the cost of this strategy;
2. Appropriate procedures for risk management are not established and this is handled thoroughly in Section 2.5.1; and
3. Progress in achieving objectives is regularly monitored and causes analyse the reasons for failure in this regard.

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

Recommendation 3 The Mayor should ensure that completion of the self-assessment checklist is critical and ensure that areas of weaknesses are proactively addressed. The possibility of updating the municipal development strategy should be reviewed which would include clear objectives and achieve municipal objectives. Further on, a revised mechanism should be applied to provide evidence supporting self-assessment allegations.

2.5 Specific Governance Reviews

Our work on specific areas of governance arrangements has been based on our audit planning which considered the context within which the Municipality operates and the challenges that it faces.

2.5.1 Risk Assessment

The Municipality is expected to implement risk assessment. Guidance set out in FMC procedures requires risk registers to be in place to support effective operational and strategic management.

Issue 4 - Failure to implement Risk Management Requirement - High Priority

Finding	The Self-Assessment questionnaire completed by Municipal staff reaffirmed that in some cases risks are taken into account, but the Municipality did not identify risks in writing yet which will jeopardise achieving the objectives and reactions if they occur.
Risk	The absence of effective risk management will reduce the management's ability to take appropriate actions and measures for reducing the risk to an acceptable level and prevent deviation of processes from normal trends.
Recommendation 4	The Mayor should ensure that a list is prepared where risks are identified according to the level and the likelihood that they may occur, and whether response measures are foreseen if they occur. Further on, the responsibility for risk management should be delegated to a responsible person who will report to management and ensure the implementation of the requirements in this field.

2.5.2 Management Reporting

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

Issue 5 - Weaknesses in High Level Management Controls

Finding	Our review of the management controls applied to the Municipality's key financial system highlighted shortcomings in formal aspect of internal reporting (reporting is made on a weekly basis verbally). This especially had an impact on the inefficient reporting on progress of capital projects, discrepancy between budget spending plan and meeting objectives and a lack of asset reporting on a periodic basis.
Risk	Poor quality financial and activity reporting to senior management has reduced management's ability to react on the weaknesses present and reduced the effect of budget controls.
Recommendation 5	The Mayor should ensure that a review is implemented to determine the format of financial reporting to senior management which is required to support effective business management and ensure that an appropriate solution is in place.

2.6 Internal Audit System

The Internal Audit Unit (IAU) operates with two members of staff - the Director of IAU and one auditor. IAU prepared an audit plan and it was approved by the management of the Municipality. This unit carried out seven audit reports as planned. Reports carried out by the IAU are: Procurement Procedures - 2014; Revenues and expenditures - 2014; whilst other reports covered 2015 review areas such as: report on revenues and expenditures in the education sector, report on MFMC; report on revenues within Directorate of economy; report on revenues in the agriculture Directorate and report on revenues within Directorate of Administration.

Issue 6 - Weaknesses in the work of the Internal Audit and Audit Committee - High Priority

Finding Audit reports carried out by the IAU for procurement and finance department focused on 2014. The IAU did not have audit programs and there was no testing approach. IAU working documentation is needed even more to develop and maintain relevant evidence on any matter raised in the internal audit reports.

Action plans in most cases were not made by the audited units and internal audit recommendations have not been implemented by the Management.

The Municipality established an Audit Committee (AC) since 2014; however the Committee has never been operational.

Risk Internal audit is not providing adequate assurance on the effectiveness of internal controls during 2015. Unidentified and weaknesses addressed by the IAU may result in financial loss to the Municipality.

Recommendation 6 The Mayor should draft an action plan, which should be implemented by confirming responsible officials including timeframe to undertake the actions. Internal audit should have a special focus on activities in the current year, having preventive effect in terms of the actions. In order to strengthen the role of Internal Audit, the Audit Committee should be operational.

3 Financial Management and Control

3.1 Introduction

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

3.2 Financial Management and Control Conclusion

In the context of financial systems, controls on certification of payments in general are poor and are not being implemented effectively. Other areas where improvements are needed are in budget planning, proper classification of expenditures, leases process management, contract management and asset management.

3.3 Budget Planning and Execution

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

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

Description	Initial Budget	Final Budget ¹	2015 Outturn	2014 Outturn	2013 Outturn
Sources of Funds	11,438,701	12,024,397	11,473,317	10,463,701	10,067,841
Government Grant -Budget	10,339,687	10,558,529	10,403,275	9,530,093	9,148,202
Carried forward from previous year ² –	0	281,748	256,666	166,113	188,362
Own Source Revenues ³	1,099,014	1,099,014	746,922	737,857	680,000
Domestic Donations	0	5,032	0	0	0
External Donations	0	80,074	66,454	29,638	51,277

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

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

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

The final budget is higher than the initial budget by €585,696. This increase is a result of donations (€85,106) and Revenues carried forward (€281,748) and government grant (€218,842) after budget review.

The Municipality used 83% of the final budget in 2015 or roughly the same level as last year (96%). In general, it can be considered a good performance and budget execution.

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

Description	Initial Budget	Final Budget	2015 Outturn	2014 Outturn	2013 Outturn
Spending of funds broken down by economic categories	11,438,701	12,024,397	11,473,317	10,463,701	10,067,841
Wages and Salaries	6,606,800	6,834,977	6,818,898	6,228,063	5,330,305
Goods and Services	656,191	781,899	771,189	634,577	693,593
Utilities	295,000	285,000	280,665	226,174	271,208
Subsidies and Transfers	150,000	150,151	142,160	105,951	93,845
Capital Investments	3,730,710	3,972,370	3,460,405	3,268,936	3,678,890

Explanations for changes in budget categories are given below:

The budget for the category of capital investments was spent on a lower level than in other categories (87%). This happened because some contracts were signed at the end of 2015. Further on, failure to execute some contracts led to low budget execution because the works were not carried out according to the contract specifications and technical committees did not accept works executed.

Table 3 Own Source Revenues for Municipality's budget - outturn against budget (in €)

Description	Initial Budget	Final Budget	2015 Receipts	2014 Receipts	2013 Receipts
Own source revenues	1,099,014	1,099,014	969,696	1,017,555	842,364

As seen from the table, the own source revenues have declined compared with the previous year by €47,859. This happened because the revenues collected from traffic fines and courts were lower than last year.

Issue 7 – Budget Execution – High Priority

- Finding** The statement of expenditures highlights a relatively low level of budget execution for capital investments. Delays in developing procurement procedures resulted in setbacks when it comes to expenditure plan.
- Risk** Poor procurement planning, i.e. contracts signed at the end of the year reduces the effectiveness of municipal capital projects and leads to budget surpluses at the end of the year.
- Recommendation 7** Approach to budget planning for capital projects needs substantial improvements. Before defining investment funds, the Municipality should carefully and objectively analyse which projects are of priority and which of them have a real chance to succeed. Timely procedures (project design, security performance, procurement, etc.) are some of the prerequisites for projects to be implemented according to plan.

3.4 Procurement

In the area of procurement we have reviewed 15 procurement procedures in total value of €1,295,498. (Contract value for capital investments was €1,107,165 and goods and services €188,333). Procurement rules are intended to ensure that public funds are used in a transparent and efficient manner to achieve value for money. The legal framework clearly defines the rights, duties and responsibilities of all parties involved in public procurement. This includes the requirement to mitigate the risk of non-completion of contracts and poor contract execution. This is achieved through the implementation of a regime of penalties related to poor performance and execution security.

We have analysed capital investment projects in Table 4.2 - Financing of Municipal Capital Investments from 2015-2017 and found that €441,900 were included as capital investments.

Issue 8 – Systematic Weaknesses in Procurement – High Priority

Finding

In three cases, the Municipality entered into obligations more than the appropriations as foreseen in Table 4.2 for specific capital projects. Such cases relate to: The construction of the school in the village Apterushe, €426,000 were planned under budget 2015-17 whilst the Municipality signed a contract in the amount €537,489; Road construction project in Rahovec was planned for 2015 in the amount of € 374,408, while the contract was signed in the amount of €514,087. Further on, “the Regulation of the old city centre with stones” €185,480 were planned under budget 2015-2017, whilst the Municipality signed a contract in the amount of €286,860.

The Municipality carried through 23 procedures (open procedures and price quotation) outside the procurement plan.

In two procurement procedures “Maintenance of vehicles” (estimated value €50,000) and “Supply with inventory for municipal needs” (estimated value of €120,000) we identified that statement of needs was not submitted to the CPA as required by Article 9, paragraph 6 of the LPP. Further on, accelerated bidding deadlines were used for these two procedures on the grounds that the requesting unit had delays in planning and the previous contract expired. This is in contradiction with Article 46 of the LPP according to which failure to plan municipal needs does not justify the use of the accelerated procedure;

A criterion in the tender dossier for the procurement procedure “Vehicle Maintenance” was that the maximum distance of garage/workshop should not be farther than 10 km from the Contracting Authority. This is in contradiction with Article 7 of LPP stating that the Contracting Authority shall not create or impose conditions or circumstances resulting in territorial, physical, material, personal or organizational discrimination between EOs.

Procurement Office in six (6) cases failed to notify in writing EOs eliminated from the tender. Pursuant to Article 54 of the LPP notification should be made in writing and the reasons for elimination should be stated.

In four (4) cases of procurement procedures we identified that the tender dossiers did not foresee the estimated quantity as prescribed by LPP and AI no.02/2015. All stages were of quantities 1, while supplies were much higher than specified in the contract.

Risk Entering into contracts by the Municipality more than the appropriations foreseen in the law on budget increases the risk that such projects are delayed, or even not finalised. The use of accelerated procedures without any compelling reason and use of discriminatory territorial criteria affects reduction of competition and favours operators. Non-compliance with the required criteria during the evaluation of bids results in rewarding ineligible Eos with contract and increases the risk of non-accountability in the process of contract execution.

Recommendation 8 The Mayor should conduct an internal review to determine why procurement requirements were not addressed in all procurement cases and exercise more controls to ensure that the systematic weaknesses identified are addressed. He should ensure that the Municipality will not enter into obligations more than the appropriations foreseen by law on budget appropriations.

Issue 9 - Non-systematic weaknesses in procurement - High Priority

Finding In the project “Construction of roads in Rahovec” contracted out in 2013 in the amount of €455,965 we identified that substantive changes were made in the works execution process from the terms of the contract. The contract signed specified 10 roads which will be adjusted. From testing two payments, we identified that street Haradinaj brothers and Mustafa Ibishi were not adjusted as contracted. Instead of Mustafa Ibishi road, contract manager obliged the supervisory body and EO to regulate segments of other local roads that were not specified in the technical specification of 2013 (not contracted). The value of this stage changed was €195,000. This is contradiction with Operational guideline for public procurement, Article 55.22 and 55.23 which foresees that changing the terms of the contract shall be prepared by the procurement department following an approval from the CAO.

Risk Paving other local roads that have not been contracted is considered to be made outside all legal and administrative procedures. Therefore, in addition to legal non-compliance, it is not clear whether or not the value for money is achieved. Such cases may cause financial loss to the Municipality.

Recommendation 9 The Mayor should examine the case why the Project Manager did not apply the terms of the contract and ensure that bill of quantity, calculations and other technical analyses for projects to be tendered are thoroughly carried out and deviations from the original contract are within allowed limits. After reviewing the case, the responsible persons should initiate appropriate accountability measures.

3.5 Expenditure not related to Procurement

3.5.1 Other payments

The Municipality made some expenditures based on Memorandums of Understanding or Cooperation. As a result of poor budget planning, the Municipality spent €122,834 of capital investment without procurement procedures based on a Cooperation Agreement with Caritas Kosovo. This is in contradiction with Article 21 of the Financial Rule no. 01/2013 on Expenditure of public money, where procurement procedures are required for every investment.

Issue 10 - Cooperation Agreement - High Priority

Finding

The Mayor entered into a Memorandum of cooperation and co-financing with Caritas Kosovo on 24.02.2015 to improve the quality of in-house and outpatient service for the citizens of the Municipality of Rahovec and in rural areas. The value of this project is €90,000 and its duration is up to 31.12.2015. Under the agreement, the Municipality's share was €75,000. The share of Caritas Kosovo for this project is €15,000 with the management staff and vehicles for visits to communities and health material for beneficiaries of the project. Further on, on 21.08.2015 the Municipality signed an annex agreement with Caritas for increasing the number of staff planned under basic agreement. According to the annex agreement, the Municipality will pay €48,627 to the account of Caritas whilst Caritas' contribution will be with management staff in the amount of €5,000. The Municipality paid €122,834 to Caritas, out of which €65,980 were paid from the category of capital investments and €56,854 from category of Goods and Services before the service is provided. These employees, according to data from Main Family Medicine Centre (MFMC) were engaged in MFMC, FMC and the Out-patient care in rural areas. Further on, the Municipality does not have any compelling evidence to ensure that if the funds committed by the donor (donor's share) under the agreement have been spent on this project.

Risk

Executing payments by the Municipality before confirming that the services are received is associated with a potential risk that the objectives of the agreements are partially met or not met at all. While the Municipality does not exercise active oversight in implementing projects and possesses no guarantee that donors will complete projects according to the agreements, these payments could be considered irregular and may cause considerable financial damage to the Municipality.

Recommendation 10 The Mayor should ensure that payments are not made before confirming that the works or services are rendered. Payments must be documented with reports confirming the receipt of the works/services. In terms of monitoring and reporting obligations arising from such agreements, it should be subject to regular reviews by the management of the Municipality. In order to eliminate the risk of failure for these agreements, we would suggest that such practices of payments are stopped.

Issue 11 - Special service contracts-Medium Priority

Finding The Municipality during 2015 hired 35 employees under special service contracts. Payments for these services were made from the category of Goods and Services in the amount of €43,404. We identified 8 employees who were engaged in a period longer than 6 months. The same have already been engaged in 2014. All contracts related to the common position, not relevant experts and simplified recruitment procedures have not been developed for the same. According to civil service law, contracts for specific services should be shorter than six months.

Risk Entering into contracts for special services for longer than 6 months is not in line with the law on the civil service, and engagements for common positions increases the cost of contracting services and this shows that the services are not in line with the real needs of the Municipality.

Recommendation 11 The Mayor should review contracts for special services and ensure that such contracts are used only for the real needs and not engage persons for common positions.

3.5.2 Remunerations (Wages and Salaries)

Wages and Salaries are paid through a centralised system (payroll). Controls operated locally relate to: a) authorization of payroll; b) verifying possible changes; and c) budget review for this category.

Issue 12 - Payments for night shifts in health - Medium Priority

Finding When reviewing the night shifts at MFMC we identified that the number of night shifts and overtime was exceeded. According to the request for action issued by the Ministry of Health dated 17.07.2013 only 8 night shifts per month are allowed whilst in 5 cases, we noticed that this number is exceeded and doubled in some months. Further on, in one case we have noticed that the number of additional hours allowed by labour law (8 hours per week) is exceeded. In some months, the norm of overtime allowed is exceeded over 100%.

Risk The exceeding of overtime and night shifts allowed besides being in contradiction with labour law it leads to unforeseen expenses for salaries.

Recommendation 12 The Mayor should ensure that of night shifts at FMC are reviewed in order not to exceed the number of overtime and labour law is considered.

3.5.3 Subsidies and Transfers

The planned budget for 2015 was €150,151 whilst €142,160 was spent. We tested five samples in the amount of €17,000 and we found no irregularities to be reported.

Recommendations

We have no recommendations in this area

3.6 Revenues

Revenues generated by the Municipality in 2015 were €969,696. These relate to revenue from construction licenses, property tax, revenues from lease, business taxes, revenues from the central level, etc.

Issue 13 - Revenues from rent and property tax - Medium Priority

Finding The Municipal Assembly on 29.04.2015 issued a decision on debt forgiveness for 50% of businesses using municipal premises. The decision on forgiveness includes 9 municipal premises. According to this decision, businesses are required to pay in advance 50% of the debt in order to erase the remaining part within three months; otherwise contracts on use are terminated. In three cases, users of premises did not pay the debt according to the decision of the Municipal Assembly (MA) and the Municipality did not take measures to terminate the contract. For three cases mentioned, the obligation to be repaid after the debts are forgiven was €27,050, and the users paid €19,550.

The Municipality failed to verify 1/3 of immovable properties, as required by the law no. 03/L-204 on immovable property tax and Administrative Instruction in force (no. 03/2011). Only 978 were verified to property or 8% of total. The survey was not done due to lack of surveying officials.

Risk Failure to adhere to the decision of MA increases the risk that lessees do not comply with the terms of contracts for paying debts. The continuation of such practices is bad precedent and could encourage other payers to avoid paying the rent. Failure to verify 1/3 of properties may result in incomplete information on actual taxable property.

Recommendation 13 The Mayor should ensure that contracts are terminated as foreseen by the decision of MA for lessees who do not fulfil their obligations to the Municipality. In the future, the Municipality's property should be verified as required by law.

3.7 Assets and Liabilities

3.7.1 Capital and Non Capital Assets

The Municipality during 2015 handled prior year recommendation for asset recording but it failed to fully implement it. As a result of continuing with the asset recording process, the Municipality reported assets within AFS in the amount of €52,206,159, or €8,377,159 more compared with the previous year. However, much remains to be done until this process is fully completed.

During further examination, we noticed:

Issue 14 - Lack of proper recordings - High Priority

Finding

Asset register was not complete and accurate. Assets Valuation Committee identified 234 plots with an area of 12.072 hectares and 8 business premises with 23,838m² owned by the Municipality. These assets were not recorded in the accounting records, because they had no financial value.

During 2015 we identified that the Municipality did not record 16 payments in the accounting records mainly those made in December 2015. Their total value was €352,871. In addition to this, we identified three payments amounting to €85,920 which were recorded 2 times in the assets register.

Project for Construction of School yard in Drenoc funded by IOM, although it was completed, the Municipality did not record it within the asset accounting records. The project value is €81,575.

When it comes to on-going investments, we identified seven projects which have been completed but the Municipality did not update the asset register to treat them as completed projects.

The Evaluation Committee evaluated that two vehicles were out of use, but they still appear as part of the municipal property registry, with a financial value of €969.

The Municipality in 2015 started to use the E-asset register and the value of assets under € 1,000 within this register was €42,607. Further on, this register included assets that are in use by the Directorate of Education and Health. These Directories, registered assets under €1,000 in Excel, but we have noticed that these data have not been updated with assets received in 2015 because 19 payments for receiving the inventory by the Education Sector in total amount of €13,644 were not recorded.

Risk Failure to fully and accurately record all property makes it difficult to identify the assets to confirm their existence, and increases the risk of their misuse and leads to understatement of municipal assets. Incomplete and inaccurate recording of assets makes the registry unreliable. Ineffective controls on asset management resulted in misstatement of assets.

Recommendation 14 The Mayor should immediately establish the competent committees for proper and complete evaluation of all non-financial assets and monitor the results of the evaluation. Recording results should be integrated into a single register for all sectors. The process of recording assets higher than €1,000 in KFMIS should be continued until the recording is finalised. Asset Management Officer and officials involved in receiving municipal assets should communicate effectively to avoid non-implementation of the Regulation and non-consolidation of assets' value.

3.7.2 Handling of Receivables

Receivables of the Municipality at the end of 2015 were €1,940,000 and compared with the previous year (€2,345,000) they are reduced by € 405,000. Reasons for decline of receivables resulted from debt forgiveness in property tax and debt forgiveness for revenues from rent.

Issue 15 - Handling of receivables - Medium Priority

Finding We reviewed the receivables and identified that the Municipality did not disclose them in the AFS correctly. The difference presented more in AFS is €3,777, and as such is not considered material.

Despite reducing the balance of these accounts, the total amount of these accounts of €1,940,000 represents a very significant amount, and as such represents a good potential to increase the self-financing resources of the Municipality.

Risk Failure to collect debt could lead to not fulfilling the spending plan. Municipality's inefficient policies on handling of these accounts have resulted in their continued growth and this increases the risk of failure to implement the planned municipal projects from its own resources.

Recommendation 15 The Mayor should systematically monitor the issue of revenue collection, to ensure that appropriate policies and measures are taken to maximize the collection of debts. It is necessary to carry out a detailed analysis setting out the reasons of delays in payments and propose concrete actions and resources needed to collect these debts.

3.7.3 Handling of Debts

The Municipality has an internal regulation when it comes to filing of invoices. In 2015 it reported obligations in Treasury on regular monthly basis. The amounts of liabilities reported in the AFS 2015 were €333,000 while it reported €731,551 in 2014, where there is a significant decline of these accounts.

Recommendations

We have no recommendations in this area.

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

Annex I: Audit Approach and Methodology

The responsibilities placed on the Auditor and Those Charged with Governance are detailed in the Opinion set out in Section 1 of this report.

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

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

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

High Priority - issues which if not addressed may result in a material weakness in internal control and where action will offer the potential for improvements to the efficiency and effectiveness of internal controls; and

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

Findings considered low priority were reported separately to finance staff.

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

Annex II Explanation of the different types of opinion applied by the OAG

(extract from ISSAI 200)

Form of opinion

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

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

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

Modifications to the opinion in the auditor's report

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

Determining the type of modification to the auditor's opinion

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

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

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

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

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

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

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

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

158. An Emphasis of Matter paragraph should:

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

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

Annex III: Prior Year Recommendations

Audit Component	Recommendation given	Implemented	Addressed but not implemented	Not addressed
1. Significant Risks to the Annual Financial Statements (Issue 1)	The Mayor should establish a commission represented by municipality key sectors, which we also suggest to include an officer from Cadastre Municipal Department, and complete the recording of all properties not recorded. This commission should prepare a summarised report, reporting on all registration results and eventual challenges, and should be presented to management. A key role in this process should be played by the assets officer, to make recording provided by this commission in KFMIS. A systematic monitoring of this process needs to be done directly by the Mayor.			X
2. Compliance with AFS and other reporting requirements (issue 2)	The Mayor should identify reasons behind misstatements made in AFS and ensure that the final review processes by management are improved when 2015 AFS are submitted. The Mayor and CFO should not sign statements without being ensured that errors are identified and adjusted prior to AFS being submitted to Government.			X
3. Prior Year Recommendations (issue 3)	The Mayor should ensure that an action plan is not produced only to meet a formal requirement, but should be a practical guide for the implementation of all recommendations. The document as such should clearly sets out a timetable and accountable staff members for implementation of activities, with initial focus on those of greatest significance. The implementation of this plan should be monitored by the Mayor on regular basis.		Yes	

4.1 Budget Planning and Execution - Payments according to court decision (issue 4)	The Mayor should ensure to make a sound budget planning, strengthen financial discipline for the execution of payments in time and should review all overdue obligations in order to eliminate such budget disorders.		Yes-partially	
5. Public Investment Programme (Issue 5)	The Mayor should ensure that Budget is planned consistently for all multiannual projects and that the PIP system is used as intended.		Yes-partially	
4.2 collection of rent for municipal properties (issue 6)	The Mayor should ensure that the agreed terms of contracts with lessees are strictly adhered to. For cases assessed that rents cannot be collected, contracts should be terminated and public auction procedures initiated for giving properties for use.			X
7. Inadequate property tax revenue planning (Issue 7)	When planning property tax budget, the Mayor should ensure that the planning process is preceded by an analysis of trends achieved during previous years, with specific focus on the level of invoicing. In addition, municipality should Implement more effective processes in tax collection to maintain minimum quota of tax which cannot be collected or bad debts.		Yes	
4.3.1. Systematic Weaknesses in Procurement (Issue 8)	The Mayor should initiate better control of contract procedures and legal requirements securing that contractual obligations are not entered into before budget funds are committed. Long-term commitments should be harmonised with project dynamics and should be planned with the Midterm Budget Framework (MTBF). Further, procurement requesting units should conduct approximate assessments for purposes of supply/purchases in cases of framework type contracts, and expenditures processing should be done according to accounting plan.			X

9. Non-systematic procurement weaknesses (Issue 9)	The Mayor should ensure that procurement procedures are used in all cases when this is applicable.	Yes		
10. Change of positions of contract in the process of execution of works (Issue 10)	The Mayor should review the contract and analyse in detail reasons behind the change of positions and should undertake immediate measures in order for the project to meet the intended purposes. Eventual amendments in contracts are decided on the foreseen level.	Yes		
4.3.2 Other expenditures-Payments through Memorandum of Cooperation (Issue 11)	The Mayor, prior to signing agreements in the future, should ensure that payment agreements are revisited ensuring transparent reporting during and after the finalization of the projects as basis for monitoring and evaluations of value for money.			X
4.3.4 Subsidies and transfers (Issue 12)	The Mayor should ensure that the internal municipal regulation for subsidy granting is implemented properly	Yes		
4.4.1 Capital and non-capital assets (Issue 13)	The Mayor should ensure that at the end of 2015 stocktaking commission and assessment of assets is established. Final reports for the management and recording results shall be processed in the assets records by the respective officer. The activities of commissions should be systematically supported and monitored by the Mayor.			X
4.4.2 Handling of receivables (Issue 14)	The Mayor should initiate an assessment process, where all accounts receivable are analysed in terms of aging, real collection potentials and establish a strategic plan for bringing the receivables down.		Yes	

4.3.7 Handling of debts (Issue 15)	The Mayor should ensure that the finance services implements all legal requirements regarding registration and payment of invoices not paid.	Yes		
4.4 Internal Audit System (Issue 16)	The Mayor should ensure that Internal Audit System is getting functionalized. A clear cooperation between actors in the system is needed. The areas for audit should be based on risks and relevant and focused toward the current year. The Mayor should manage internal audit recommendations better.			X