



REPUBLIC OF KOSOVA
OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE MITROVICA
NORTH ADMINISTRATIVE OFFICE FOR THE YEAR ENDED 31
DECEMBER 2012

Prishtina, June 2013

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

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

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

The Auditor General has decided on the audit opinion and the report on the Annual Financial Statements of the Mitrovica North Administrative Office in consultation with the Assistant Auditor General, Qerkin Morina, supervising the audit.

The opinion and report issued are a result of the audit carried out under the management of the Audit Director Florim Beqiri supported by Stana Dancetovic (Team leader), Svetlana Perovic, and Nebojsa Ristic.

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Executive Summary

Introduction

This report summarises the key matters arising from our audit of the 2012 Annual Financial Statements (AFS) of Mitrovica North Administrative Office (MNAO). I would like to thank the Chief Executive Officer and his staff for their assistance during the audit process.

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

Our audit focus has been on:

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

Opinion

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

In our opinion the Annual 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 fully reliable. The registry of fixed assets does not affect any of the 2 Annual Financial Statements (Cash Receipts and Payments and Comparison of Budget and Actual Amounts) in line with IPSAS Cash based accounting. **(ISSAI 400 Unqualified Opinion with an Emphasis of Matter)**

Overall Conclusion

The level of work undertaken by the OAG to complete the 2012 audit is a direct reflection of the quality of the internal control environment implemented by the Management.

Our overall conclusion is that current system of internal controls does not provide sufficient assurance in order that MNAO to meet its objectives successfully. During our audit work, we have noticed weaknesses in several key areas of financial management.

- Failure to meet requirements for external reporting;
- Poor planning and collection of own source revenues;
- Lack of information disclosure for assets in the AFS;
- Avoiding procurement procedures;
- Incomplete tender dossiers; and
- Failure to record assets.

Our key recommendations for Chief Executive Officer are as follows:

Annual Financial Statements

- Assets under and over €1,000 and stocks at the end of the year should be fully disclosed.

Financial Management and Control

- Budget is planned on sustainable basis and additional measures are taken for revenue collection;
- Strengthening of control over the implementation of procurement procedures, in order that all procurement activities are carried out in accordance with the LPP; and
- All assets owned by MNAO should be registered, and the registry should be continuously updated.

Internal Audit System

- Internal Audit Unit should make further efforts to meet the annual audit plan.

Management Response - 2012 audit

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

1 Audit Scope and Methodology

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

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

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

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

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

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

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

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

2 Annual Financial Statements

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

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

2.1 Compliance with the Reporting Framework

Overall Conclusion

Draft Financial Statements were not prepared in accordance with the deadline of 31.01.2013. Those were prepared on 14.02.2013 and did not include all the requirements as by the Financial Rule no. 07/2011, and IPSAS "Financial Reporting under the Cash Basis of Accounting".

Description

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

- AFS were signed by the CAO and CFO;
- Financial Statements were prepared in electronic format and hard copy;
- AFS were not prepared within the deadline. They were prepared on 14. 02. 2013 and submitted to the MoF;
- AFS were submitted only in Serbian;
- Nine-month report for 2012 was neither prepared nor submitted to MoF; and
- Outstanding liabilities were not reported in Treasury.

Recommendation

We recommend MNAO management to ensure that when preparing AFS, all requirements in accordance with the financial rule are included, as well as requirement for preparation in both languages.

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

Overall Conclusion

MNAO's draft AFS prepared on 14.02.2013 for the year ended on 31.12.2012, were not in accordance with Financial Rule no. 07/2011. They were incomplete, inaccurate and misleading, therefore during the audit process, we requested from the Management to correct draft AFS. Upon our request, except the disclosure of non-financial assets, statements were adjusted and delivered to the OAG on 18.03.2013.

1. Issue - AFS Production Process - Priority Significant

Finding In note 30 and 31: Summary of capital non-financial assets valued over and under €1,000, the Office failed to present the value of assets;

Risk An incomplete AFS production plan may result in incomplete or incorrect AFS with the risk that statutory requirements are not met

Recommendation 1 CEO should ensure that the 2013 AFS production plan formally addresses all compliance requirements related to the AFS.

2.3 Audit opinion

In our opinion the Annual 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 fully reliable. The registry of fixed assets does not affect any of the 2 Annual Financial Statements (Cash Receipts and Payments and Comparison of Budget and Actual Amounts) in accordance with IPSAS Cash based accounting. **(ISSAI 400 Unqualified Opinion with an Emphasis of Matter)**

3 Prior Year Recommendations

Overall Conclusion

Mitrovica North Administrative Office is newly established organization. It started its work in June 2012. This is our first audit of MNAO AFS.

4 Financial Management and Control

4.1 Introduction

Our audit approach is focused on understanding and evaluating the actions taken by management to ensure effective financial management and control. For individual financial systems we seek to identify the level at which actual controls operate. This may, for example, be monitoring activity undertaken by senior management or lower level operational controls. We consider whether controls are well designed, have been implemented as planned and operate effectively. This requires an assessment of structures, processes and accountability lines presented by management.

The MNAO's internal control system is mainly weak. This is understandable to a certain extent, since only for a few months of its operation is natural that this Office could not establish and develop an adequate system of internal control. Shortcomings can also be found in control design, but also in implementation of the existing ones. Office did not manage yet to produce internal rules and procedures, in order to clarify and simplify daily operational activities.

4.2 Budget Planning and Execution

Overall Conclusion

MNAO spent only 43% of the budget approved by the Kosovo Assembly, but this budget non-execution is reasonable, given that the Office operates since June of 2012, and problems such as lack of staff and many other problems related to newly established administration caused the failure in budget execution. However, MNAO is consolidating relatively quickly.

Description

We have considered the MNAO's source of budget funds, expenditures by economic categories and revenues collected. This is highlighted in the tables below.

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

Description	Initial Budget	Final Budget ¹	2012 Outturn	2011 Outturn	2010 Outturn
Sources of Funds	2,789,500	2,939,125	1,258,658	0	0
Government Grant - Budget	2,779,500	2,779,500	1,258,658	0	0
Carried forward from previous year ² -	0	0	0	0	0
Own Source Revenues ³	10,000	10,000	0	0	0
Domestic Donations	0	0	0	0	0
External Donations	0	149,625	0	0	0

Based on the data presented in the table, we can see that MNAO's final budget differs from the reviewed budget for €149,625. This difference is due to the Norwegian Government's donation.

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

Description	Initial Budget	Final Budget	2012 Outturn	2011 Outturn	2010 Outturn
Spending of funds by economic categories	2,789,500	2,939,124	1,258,657	0	-
Wages and Salaries	1,444,655	1,444,655	857,591	0	0
Goods and Services	159,712	309,337	130,751	0	0
Utilities	57,359	57,359	642	0	0
Subsidies and Transfers	10,000	10,000	0	0	0
Capital Investments	1,117,774	1,117,774	269,673	0	0

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 Own source revenues budgeted

In Table 2 we can see that only 43% of the budget is spent. Reasons for such a low execution rate are related to many problems faced in the initial stage of establishing.

Table 3 Own source revenues planed and realized (in €)

Description	Initial Budget	Final Budget	2012 Outturn	2011 Outturn	2010 Outturn
Own source revenues	10,000	10,000	107	-	-

Own source revenues planned for 2012 were €10,000, but MNAO, in the period from June to December 2012 managed to collect only €107.

4.3 Reporting Requirement

Overall Conclusion

MNAO did not meet the reporting requirements and failed to comply with deadlines.

Description

MNAO did not fulfil obligations relating to external reporting and in this aspect the following shortcomings were noticed:

- Nine-month financial statements were not prepared;
- Draft procurement plan was not prepared given that it started to operate in second half of the year;
- Self assessment report was not prepared;

Recommendations

We consider many challenges in establishment phase but we recommend that for 2013 Chief Executive Officer should ensure that requirements for external reporting are met.

4.4 Revenues (including own source revenues)

Overall Conclusion on Revenues

Planned own source revenues were €10,000 while only €107 were collected. Therefore, this office collected only 1% of revenues compared with planned amount.

Revenues were generated by urban and cadastre units, mainly from issuing business activity licenses, issuing urban plan copies and from legalising business premises.

Recommendations

MNAO should prepare a revenue collection plan based on detailed analysis and on real possibilities for applying payments (fees) as provided by law, and to approve a clear policy and adequate mechanisms prescribed by law for applying the collection of own source revenues.

4.5 Expenditures

Overall Conclusion on Expenditures

MNAO still did not manage to establish adequate controls on expenditures, from initiating the request up to contract execution. Since municipal administration has still many challenges in normally performing its functions, we understand the current situation. However, we encourage the Chief Executive Officer to continue establishing appropriate controls within the PIFC framework.

4.5.1 Procurement

Description

Purchases made through procurement procedures in 2012 were in the amount of €368,603.

We have tested 12 contracts (subjects) in the amount of €141,389 which have passed through procurement procedures and we have also tested payments related to these contracts. During testing, we noticed that MNAO implemented some of procurement procedures, for which we cannot say that are fully comply with the Law on Procurement.

2. Issue - Contract signed before initiating procurement - Priority Significant

Finding	The contract no.062/2012 "Construction works for setting the power transformer for MNAO " in the amount of €8,935, contract no.063/2013 "Setup of the power transformer" worth €9,750 and contract no.064/2012 "Setup of the power transformer" in the amount of €9,370, in all three cases, the Office signed a contract
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with the company, before the initiation of the procurement procedures. The contract was signed on 18.12.2012 and the minutes of the bid opening were on 24.12.2012.

Risk Signing the contract before the initiating procurement process is not in accordance with the procurement rules. Furthermore, starting with works before having a contract, conditional the contracting of works, regardless of market competition.

Recommendation 2 Chief Executive Officer should establish practices of signing contracts after performing procurement procedures, taking into consideration the preliminary evaluation of bids.

3. Issue - Lack of tender dossier for two economic operators- Priority Significant

Finding The contract "Supply with furniture for CAO's cabinet" in the amount of €9,750, we have noticed that the only tender dossier is of the winning EO, while tender dossiers of two other bidding EOs do not exist, although they were mentioned in the minutes of the tender opening.

Risk Shortcomings in documentation of procurement dossiers increase the risk when it comes to transparency process. No assurance can be taken whether the best operator was awarded with contract.

Recommendation 3 Chief Executive Officer should take measures to strengthen administrative controls in procurement, in order to ensure that procurement dossiers contain all the evidence on process development. In case if procurement staff has insufficient professional competence, training in this field should be provided.

4. Issue - For the same procurement, two bids with different prices from the same EO - Priority Significant

Finding During the audit we noticed that in two cases the same EO applied with two bids and with different prices for the same procurement. The contract no. 062/2012 "Construction works for setting MNAO's power transformer" one bid had a price of €9,525 and the other €8,935. In this case, the contract was signed with the lowest price.

Further on, the contract no. 064/2012, "Setting up power transformer for MNAO" in the amount of €9,370, the contract

winner has offered with two bids at different prices. One was in the amount of €9,700 and the other €9,370.

Risk Signing a contract with the EO that in their tender dossier had two bids, leads to the judgment that tendering procedure is not implemented in accordance with the law.

Recommendation 4 Chief Executive Officer should ensure that procurement process takes place only under specific requirements of the procurement rules, that it is clear and avoids the possibility of doubts in the process. The exact specification of the price within a bid is one of the primary requirements of evaluation.

5. Issue - Tender documentation partly completed and not signed – Priority Significant

Finding Some shortcomings were noticed in the following contracts:

- “Supply with gifts for end of year for children of different communities” in the amount of €9,350,
- “Supply with firewood for the needs of different communities” in the amount of € 9,900, and
- “Supply with note-books and calendars” in the amount of €9,800.

In these cases, the tender dossier is incomplete, because the tender receiving registry was not signed by the economic operators, and bids evaluation, in all three cases, was made on the same date by the same evaluation committee. We have also noticed that 18 contracts were signed on 18.12.2012.

Risk Contracts were awarded to bidders without any valid explanation, on the same day. Evaluations made by the same committee and on the same day, only fulfilled the formal aspect, rather than quality aspect of the process. Lack of operator’s signatures, raises doubts of their participation in the process.

Recommendation 5 Failure to follow proper procurement procedures and accompanying instructions, resulted in improper payments and financial loss to the MNAO. There is a further risk that was achieved a poor value for money spent on these contracts.

4.5.2 Remunerations (Wages and Salaries)

Description

For 2012, the budget for wages and salaries was in the amount of €1,444,655, and €857,591 or 59% were spent. The low level of budget execution in this category is due to the fact that MNAO failed to perform the recruitments planned.

Wages and salaries are paid through a centralised system. Controls operated locally by MNAO related to: a) control on payment of salaries by signing the payroll list each month, b) approval of possible changes that may occur through forms c) budget review for this category and reconciliation with the Treasury.

For this category, we tested 38 samples where we considered whether the amount of salaries from payroll list complies with the contract and payroll. Also we considered whether the amount of the salary is in accordance with the coefficient as foresees by law for particular job descriptions, or for the designated employment position. We found that cases we referred to are in accordance with legal rules.

6. Issue - Personnel data - Priority Significant

Finding Review of Personnel Files identified that the following documentation is missing: evaluation reports, evidence for vocational training and work experience, job description.

Risk The data are insufficient to justify the regularity of recruited staff, their professional skills and identifying training needs.

Recommendation 6 Executive Chief Officer should do a systematic review of personnel to ensure that all necessary documentation is included, within a specified period of time. Also, measures should be taken regarding the payroll signing.

4.6 Assets

Overall Conclusion on Assets

MNAO has initiated the registration process of its assets in the accounting records, but this process should continue until all assets are registered in the accounting records and in KFMIS. MNAO should establish a Committee for evaluation and registration of the assets, as well as appointing an Assets Officer.

4.6.1 Capital and non capital assets

Description

We have noticed that MNAO has not appointed an Asset Officer. There is a Logistics Officer, but according to organizational scheme he is also Chief of Logistics/driver. Therefore, he has kept no records of asset received or evidence of assets available, and he doesn't have a stocks registry.

MNAO did not start to record its assets in KFMIS. We encourage the MNAO that after appointing the Assets Officer to start with necessary recordings in KFMIS.

4.7 Handling of debts

Overall Conclusion regarding Handling of Debts

MNAO has not reported outstanding debts (invoices) to MoF, although we found a small amount of such liabilities.

Description

After our review, we noticed that the statement of liabilities to suppliers, at the end of 2012, was €3,093. These liabilities are carried forward for payment in fiscal year 2013 and are related to liabilities incurred from procurement of Goods and Services. The reason why these liabilities remained unpaid was delay in submitting invoices in December 2012.

5 Internal Audit System

Overall conclusion on Internal audit system

Internal Audit Unit started to work in the second half of 2012. The Internal Auditor conducted only one audit during 2012. Although newly established as a unit, the internal auditor showed a great commitment in reviewing internal controls, as well as improving the quality and effectiveness of controls.

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.

MNAO has appointed an internal auditor, who is also the Director of IAU. IAU has not developed a strategic plan. Because of the short duration of its activity, we are not able to draw conclusions on the final quality of this function, but we can say that the internal auditor is deeply committed to fulfil its function. However, he must attend training in this area, in order to be able to perform his work in accordance with the standards required.

6 Overall conclusion

Our overall conclusion reflects our review of the controls associated with the AFS, Financial Management and Control and the Internal Audit System.

Based on the findings of this report, we conclude that responsible management did not yet managed to establish operational controls securing effective management of the organisation. Managerial shortcomings are reflected in budget execution, which is a result of not recruiting appropriate staff and failure to plan and make purchases through procurement. In particular, the weaknesses were noticed especially in understanding the procurement procedures, which were not developed fully in compliance with the applicable legal framework, shortcomings on personnel files, lack of assets records and their presentation in the financial statements.

Management should have a clear understanding of public finances internal control framework and should make all staff aware on requirements of this document. Self awareness for the need of controls should be continuously developed.

MNAO is making the first steps towards establishing its resource management. Difficulties related to the establishment up to full consolidation of administrative departments still exist. The current staff is not sufficiently prepared to face with daily challenges. Lack of skills and working knowledge, reflected in errors and irregularities identified above. Identifying areas for staff training is an immediate task.

The internal auditor should cooperate closely with the CHU/IA, in order to gain experience and professional assistance of this unit. Also, cooperation with IAUs from other municipalities will help raise his capacity.

All these lead to the conclusion that the MNAO Management should make serious efforts to eliminate shortcomings identified and build an effective municipal administration.

We recommend the Chief Executive Officer to:

Produce a package of decisions, instructions, written policies and procedures which would constitute a sufficient legal base for achieving its objectives, operational performance and internal control systems. The use of models and experiences of municipalities with many years of tradition and good practice would be a great help for the MNAO management.

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

(extract from ISSAI 400)

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

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

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

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

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

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

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

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

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

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

