



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

Document No: 22.37.1-2014-08

**AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE MUNICIPALITY OF
MITROVICA NORTH
FOR THE YEAR ENDED 31 DECEMBER 2014**

Prishtina, June 2015

The Office of the Auditor General undertakes both Regularity and Performance Audits. The Acting Auditor General, is the head of the Office of the Auditor General which employs around 145 staff. The Auditor General and the Office of the Auditor General 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 Office of the Auditor General directly promote accountability as they provide a base for holding managers’ of individual budget organisations to account.

The Acting Auditor General has decided on the audit opinion and report on the Annual Financial Statements of the Municipality of Mitrovica North 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, Bujar Sejdiu, supported by Svetlana Perović (Team Leader), and team members Stana Dančetović and Agim Sogojeva.

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Executive Summary

Introduction

This report summarises the key findings from our audit of the 2014 Annual Financial Statements of Municipality of Mitrovica North which determine the Opinion given by the Auditor General. I would like to thank the Mayor and his staff for their assistance during the audit process.

The examination of the 2014 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 07/10/2014.

Our audit focus has been on:



The level of work undertaken by the Office of the Auditor General to complete the 2014 audit is a direct reflection of the quality of the internal controls implemented by management.

Opinion

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

The Auditor General's opinion is:

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

As an *Emphasis of Matter* we would like to draw your attention to the fact that the disclosure of the Fixed Assets in the AFS were not complete.

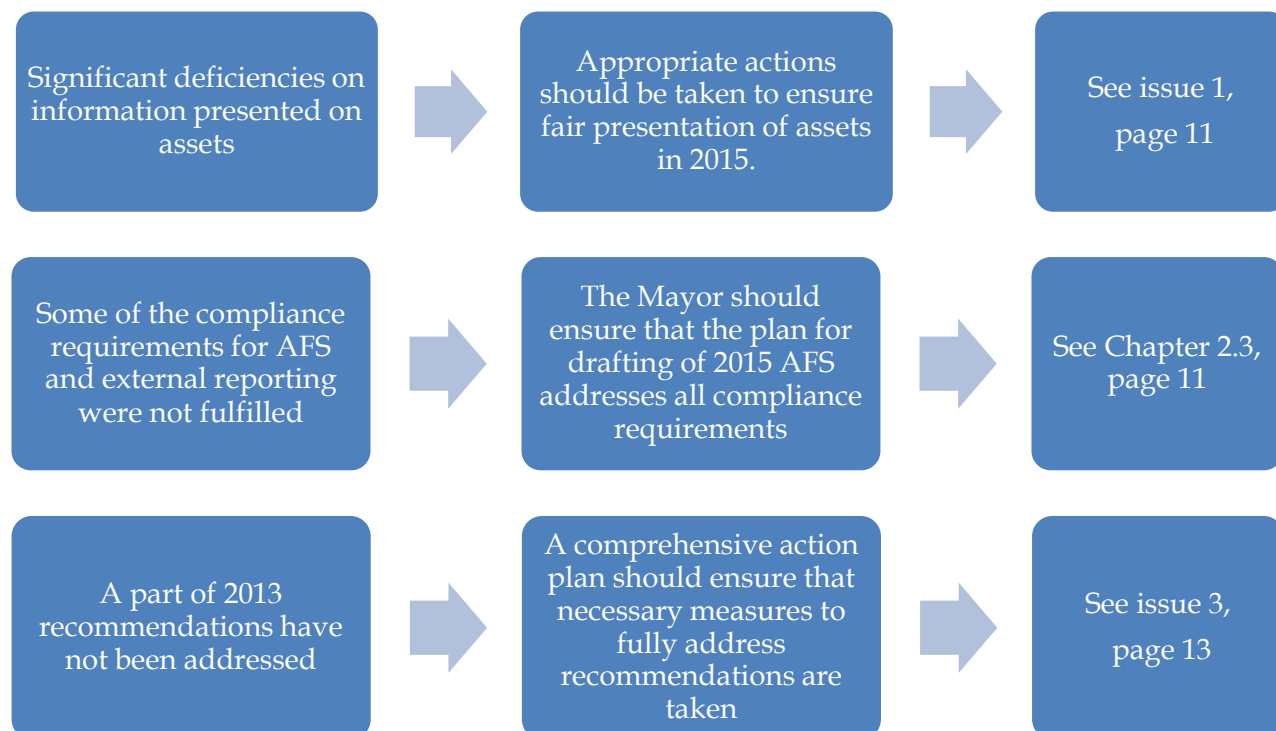
Other issues

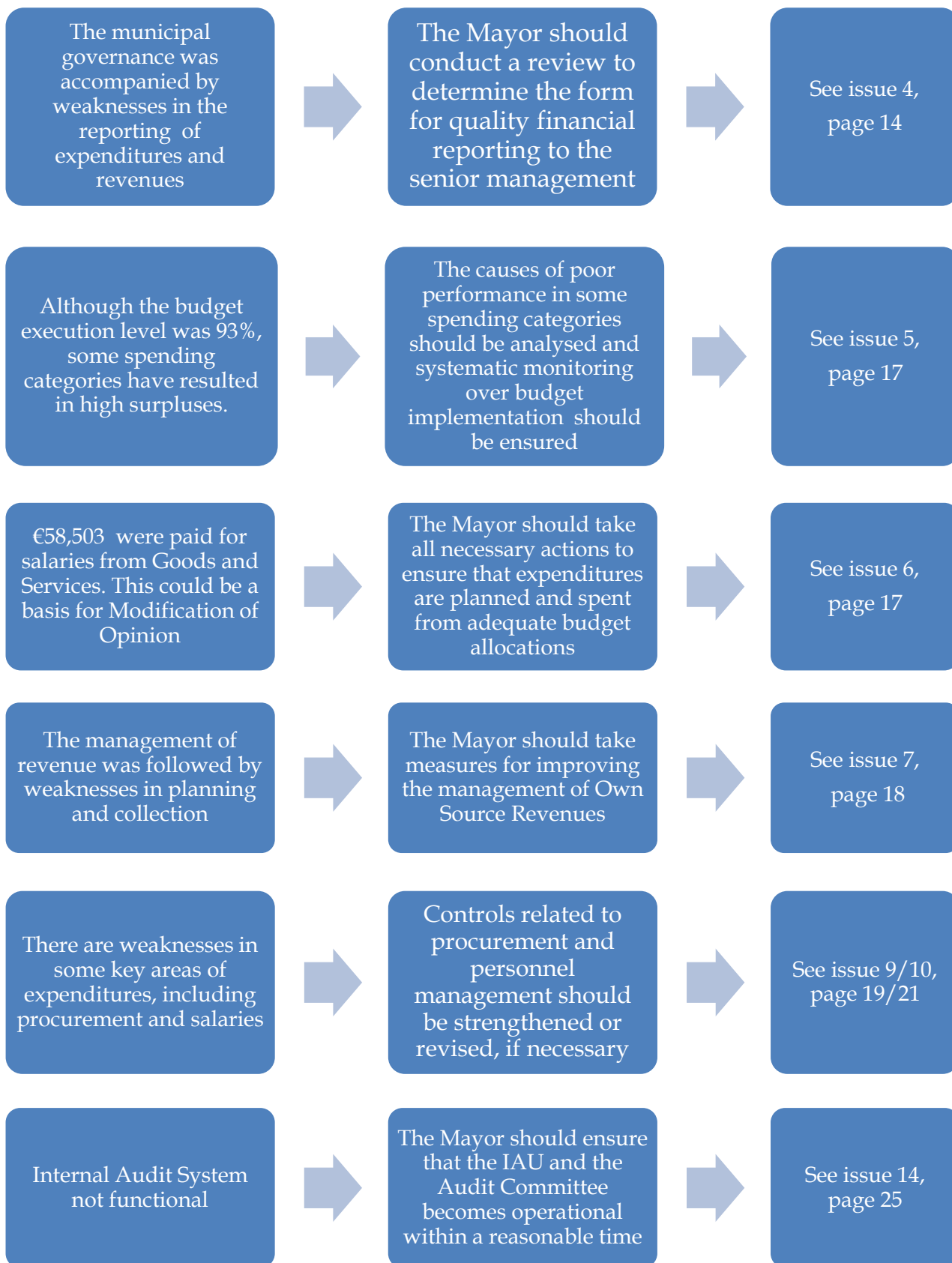
The capital investments in the AFS were overstated by €9,800 and goods and services were overstated by €58,503 due to misclassification of expenditures.

(ISSAI 200/1706: Unmodified Opinion with an Emphasis of Matter).

Overall Conclusion

Our key conclusions and recommendations to the Mayor are:





Management's Response - 2014 audit

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

We take it for granted that the Mayor:

- table the Audit Report for discussion in the Local Assembly; and
- during January/February 2016 initiate a discussion in the Local Assembly regarding the implementation of the Action Plan on audit recommendations, before AFS 2015 are submitted to Ministry of Finance.

1 Audit Scope and Methodology

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

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

We have considered the extent to which management controls can be relied upon when determining the overall testing required to provide the necessary level of evidence to support the Auditor General's (AG) opinion. Management activity also determines the focus of our compliance audit and good governance audit which do not directly impact on the opinion.

Our audit approach to governance is focused on evaluating the actions taken by management to secure effective financial management and control and the results of this action in efficiently delivering high quality operational outputs. For individual financial systems we seek to identify the level at which actual controls operate. This may, for example, be monitoring activity undertaken by senior management or lower level operational controls. We consider whether controls are well designed, have been implemented as planned and operate effectively. This requires an assessment of structures, processes and accountability lines introduced by management including the role undertaken by Internal Audit and Audit Committees as well as inbuilt system controls.

The following sections provide a more detailed summary of our audit finding with emphasis on observations and recommendations in each area of review. An assessment of how the Management have addressed recommendations made in the report on 2013 may be found in Annex II.

For completeness we have included issues identified at the interim audit where they remain relevant. At the interim audit stage we provide advice to enable relevant action to be taken in advance of the AFS production and final audit. Our findings are defined as:

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

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

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

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

2 Annual Financial Statements and other External Reporting Obligations

Description

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 Mayor 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.

Overall Conclusion

The overall quality of AFS was good, except for assets disclosure. As was mentioned in this report, other external reporting obligations that do not relate to the AFS were met, except for the self-assessment report.

2.1 Audit Opinion

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

As an *Emphasis of Matter* we would like to draw your attention to the fact that the disclosure of the Fixed Assets in the AFS were not complete.

Other issues

The capital investments in the AFS were overstated by €9,800 and goods and services were overstated by €58,503 due to misclassification of expenditures.

(ISSAI 200/1706: Unmodified Opinion with an Emphasis of Matter).

2.2 Significant Risks to the Annual Financial Statements

Description

Our Audit Planning Memorandum dated 7.10.2014 identified one significant risk to the AFS related to the completeness of assets.

The risk of material misstatement that we identified relating to the completeness of assets occurred because no management action was taken to address the highlighted risk. This lack of action can result with Emphasis of Matter.

Identified Risk

Issue 1 - Failure to record all assets can result in material understatement of assets values in the AFS

Audit response and Findings

During our interim audit we reviewed management's controls and following processes to ensure a complete assets registry. We have provided advice to management on actions that should be taken so that the value of assets in the AFS is correct. However, the risk identified has materialised because the management has not managed to implement adequate controls over assets management that would ensure their complete presentation in the AFS.

Recommendation 1 High Priority - The Mayor should initiate an analysis of the causes that have led to incorrect presentation of assets values in the AFS. The Mayor should identify appropriate actions to address these weaknesses in order to ensure complete disclosure of assets in the 2015 AFS. This process should be systematically monitored by the Mayor.

2.3 Compliance with AFS and other reporting requirements

Description

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

- Compliance with the Financial Rule no. 03/2013;
- Requirements of LPFMA no. 03/L-048;
- Whether the AFS have been published in Albanian and Serbian and in time;
- Whether the AFS have been signed by the Mayor and Chief Financial Officer (CFO);
- Regular quarterly reporting to the Municipal Assembly and the Ministry of Finance;

- Performance reports; and
- Whether draft and final procurement plan was prepared on time.

In the context of the AFS, we have identified some discrepancies. In Notes 31 and 32, Municipality assets disclosures were incomplete. In the context of other external reporting requirements, we have identified that the Municipality had not prepared the self-assessment report as required under the FMC procedures.

Recommendation 2 High Priority - The Mayor should ensure that the 2015 AFS production plan addresses all compliance requirements related to the AFS. The Declaration made by the Mayor and CFO should not be submitted unless all necessary checks have been applied to the draft AFS. The Mayor should also ensure that all external reporting requirements are met.

3 Prior Year Recommendations

Overall Conclusion

Although the Municipality prepared an action plan for implementation of 2013 recommendations, a part of recommendations has not been addressed yet.

Description

Our Audit Report on the 2013 AFS resulted in 18 key recommendations. By the end of our 2014 audit, seven have been fully addressed; three are partially addressed; and eight are not addressed yet.

For a more thorough description of the recommendations and how they are addressed, see Annex II.

Issue 3 - Addressing Prior Year Audit Recommendations - High Priority

Finding Around 1/3 of prior year recommendations have been implemented because the management has not implemented any formal process to manage and monitor the way that the AG's recommendations are implemented.

Risk Failure to address recommendations results in continuous weaknesses of controls in key financial systems. The recommendations have not been addressed in key areas, such as revenues, expenditures, salaries, subsidies and assets. As a result, same weaknesses are repeated. This undermines the achievement of objectives and may result in poor value for money.

Recommendation 3 The Mayor should ensure that a revised action plan clearly sets out a timetable for addressing the recommendations for 2013, as well as the recommendations for 2014, with accountable staff members identified and with initial focus on those of greatest significance. The implementation progress of this plan should be directly supervised by the Mayor.

4 Governance

Overall Conclusion

Proper governance is intended to support effective planning, implementation and monitoring of Municipality's activities. Key aspects that need to be addressed by the Municipality of Mitrovica North to ensure a sound governance framework are clear procedures and adequate segregation of duties for process management, risk management, systematic monitoring of activities and self-assessment.

Municipality of Mitrovica North has not managed yet to establish necessary arrangements to ensure these governance aspects are fulfilled. Despite the Municipality's commitment to establish an appropriate management and control system, this was not achieved, and there is much room for improvement. A key aspect to ensure required development is a good transition process ensuring that culture and practices from the former Administrative Office (AO) and current Municipality are met in order to create a sustainable base for effective service to citizens.

4.1 Good Governance

Description

The management and control of public finances is implemented through the integrated system of daily operational and financial activities. In order to ensure effective financial management, an effective and timely reporting process is needed.

Recommendations

Issue 4 - Weaknesses in reporting processes - High Priority

Finding Our review has identified weak management control over Municipality's expenditures and revenues. This was because the management has not established managerial reporting processes that provide explanations regarding the differences between the budget and execution. Furthermore, the responsibilities of former AO and the current Municipality have not been fully harmonised yet. Accordingly, municipality activities have not reached its full potential.

Risk Weak accountability and poor quality financial reporting to the management reduces the the possibilities for monitoring and effectiveness of activities and budgetary control of the Municipality. This may result in over- or under-spending not followed by necessary measures for improvements. Shortcomings in the transition may lead to shortcomings in services, ineffective monitoring and poor decision-making processes.

Recommendation 4 The Mayor should initiate a review of the current reporting practices to determine the quality of reporting on finances and results forming a sufficient base for senior management monitoring to ensure effective business management. A suitable solution should be presented by the end of the 2015.

4.2 Budget Planning and Execution

Description

Budget allocations to the Municipality of Mitrovica North are included in the budget line of the former Administrative Office of Mitrovica North. 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	2014 Outturn	2013 Outturn	2012 Outturn
Sources of Funds	4,078,656	4,779,314	4,427,037	3,745,762	1,258,657
Government Grant -Budget	3,973,256	4,657,279	4,402,433	3,573,187	1,258,657
Carried forward from previous year ² -	0	11,944	12,660	20,500	0
Own Source Revenues ³	105,400	105,400	11,944	0	0
External Donations		4,691	0	152,075	0

The final budget is higher than the initial budget by €700,658. This increase is a result of:

- Increase of the Government Grant by €684,024;
- Revenues carried forward from 2013 by €11,944; and

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.

- Donation from the Norwegian Government by €4,691.

The final budget execution in 2014 is 93%, representing degree of improvement by 16% compared to 2013. Explanations on the current position are presented as follows:

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
Spending of funds broken down by economic categories	4,078,656	4,779,314	4,427,037	3,745,762	1,258,657
Wages and Salaries	2,520,000	3,208,664	3,173,582	2,376,703	857,591
Goods and Services	475,990	476,040	369,630	628,519	130,751
Utilities	39,072	39,072	20,642	39,071	642
Subsidies and Transfers	110,000	121,944	67,166	49,584	0
Capital Investments	933,594	933,594	796,017	651,885	269,673

Explanations for changes in budget categories are given below:

- The budget for Wages and Salaries increased with €688,664 in 2014. This was due to the Government's Decision to increase salaries by 25% and due to the transfer of personnel employed in health and education to the Kosovo payroll system. As a result, the level of spending in this category was at 99% of the final budget, which is 17% higher compared to the previous year:
- Expenditures for Goods and Services for 2014 were at the level of 78% of the final budget. This level indicates a decline of spending of final budget by 19% compared to the previous year. The budget for Utilities was spent at 52%;
- Despite the fact that the budget for Subsidies and Transfers increased by €11,911, the final budget was spent by 55%, or 14% lower than in the previous year. This low level of spending was due to lack of a municipal strategy to support projects through subsidies; and
- The final budget for Capital Investments was spent by 85% indicating an improvement of 31% compared to the previous year. However, the fact that 78% of expenditures have incurred in the last quarter indicates poor planning for management of capital projects.

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
Revenues	105,400	105,400	20,532	10,612	107

Only 19% of the Own Source Revenues collection plan for 2014 was implemented. The collection of Own Source Revenues remains at an extremely low level. This was because the Municipality

planned revenues from construction permits but did not collect any. This shows lack of effective mechanisms for collection of planned revenues.

Although the revenue plan was only partially implemented, the fact that revenues have doubled compared to previous year is positive.

Recommendations

Issue 5 – Budget Execution – High Priority

Finding Even though the overall budget execution was at the accepted level, the budget components of utilities and subsidies were spent at a low level compared with plans. The largest part of expenditures have incurred in the last quarter, whilst donations have remained completely unspent. These show the Municipality's weakness in budget planning and in the systematic budget control due to reflection of the transit period.

Risk Inadequate budget planning and execution results in poor performance and reduces the Municipality's effectiveness in achieving the objectives. On the other hand, failure to fully execute the budget program could result in reduction of the government grant and loss of donations that hinder the overall development of the Municipality.

Recommendation 5 The Mayor should initiate an analysis of the causes that led to weak budget performance in certain economic categories. The Mayor should ensure that budget planning reflects the Municipality's needs and capacities and should systematically monitor execution against planning.

Issue 6 – Overstated Goods and Services – High Priority

Finding The Municipality paid €58,503 from Goods and Services for salaries of the municipal advisors. This was because the Municipality has not managed to plan the needed amounts in the category of Wages and Salaries.

Risk Overstated Goods and Services may lead to misunderstanding of the financial position of the Municipality and can be used as a base for Modification of the Opinion.

Recommendation 6 The Mayor should ensure that all actions are undertaken in order to have all expenditures planned under the appropriate budget allocations, and that they will not be subject to misclassification.

4.3 Revenues (including own source revenues)

Description

The overall revenues of the Municipality of Mitrovica North for 2014 were €20,532. These revenues are generated from the administrative fee, heritage registration fee, birth and death certificates fee, and other fines.

The Municipality has made progress in establishing controls over the management of its own source revenues, but these controls should be applied firmly, strengthened and monitored in a systematic way in order to give the expected result.

Recommendations

Issue 7 - Weaknesses in revenue management - High Priority

Finding The management of the Municipality has not implemented effective policies related to revenue. It seems that the problem is of political nature and citizens refuse to pay state taxes. Weaknesses identified are:

- Adequate processes for a realistic and implementable plan of municipal revenues are missing. Due to this only 19% of the plan was implemented; and
- Lack of effective mechanisms and ensuring the collection of revenues from property taxes and construction permits.

Risk Existing weaknesses will result in low level of own source revenues collection. As a result, the Municipality will face non-implementation of the plan and reduced opportunities for implementing projects expected to be financed from own source revenues.

Recommendation 7 The Mayor should be more determined in collecting taxes as own source revenues are returned to the citizens in form of projects or services.

4.4 Expenditures

4.4.1 Procurement

Description

In 2014, purchases made through procurement procedures were €913,686. Therein are included capital investment and the largest part of goods and services. Due to replied weaknesses from prior years the procurement continues to be a challenge for the Municipality.

Recommendations

Issue 8 - Weakness in procurement - Medium Priority

Finding Our review of procurement contracts identified that the Municipality had not fully implemented the LPP. As a result the following weaknesses have occurred:

- The payment of €9,800 for “Cleaning and maintenance of public green spaces” services was made from the category of Capital Investments;
- Two works contracts of €69,820 were entered into even though Economic Operators (EO) had not provided valid evidence on the number of employees engaged.

Risk Weaknesses encountered indicate lack of effectiveness in procurement controls. This may result in a violation of the law and Operators’ failure to complete the works.

Recommendation 8 The Mayor should review procurement controls and establish additional controls to ensure that the process is regular and effective. All payments should be made in adequate codes and contracts should be entered into only with EOs that meet all the tender criteria fully in compliance with the LPP.

Issue 9 - Weakness in using “price quotation” - High Priority

Finding We found that 43 out of 83 procurement procedures implemented during 2014 were conducted with price quotation procedure. The total value of contracts signed through quotation was €348,689. The following cases could have been subject to deliberate division of contracts:

- On 12.12.2014, the Municipality entered into two contracts, through price quotation for supply with items of similar nature. One was for “Purchase of fire-fighters uniforms” in the amount of €8,910 and the

other for “Purchase of fire-fighting equipments” in the amount of €3,200; and

- On 19.12.2014 six contracts of €49,560 were signed for supplies of the same nature, such as inventory, equipment and medical supplies. Price quotation procedure was applied in all contracts, thus avoiding open procedures. Furthermore, the information in invoices and received goods were not the same with those in the Tender Dossier.

Risk Using the quotation procedure for expenditures that can be incurred through open procedure increases the risk of obtaining poor value for money, eliminates competition, and may be subject to fraud. On the other hand, the mismatch between the received goods and invoices with the Tender Dossier may result in irregular payments.

Recommendation 9 The Mayor should strengthen controls over planning and carry out a timely assessment on needs for purchases/supplies during the year in order to ensure that open procedures are used for items of same nature and that the most reasonable prices are obtained from the market. In addition, while receiving goods/services quantity, prices, and quality should be confirmed in line with the contracts, and then payments should be certified.

4.4.2 Non Procurement Expenditure

Description

Non-procurement expenditures relate to goods and services not subject to procurement. Examples of these expenditures are utilities, travel advances, official lunches, petty cash expenditures, etc. Controls over some aspects of non-procurement expenditure process are not applied effectively. These are handled under Chapter 4.5.2.

We have no recommendations in this area.

4.4.3 Remunerations (Wages and Salaries)

Description

Expenditures for Wages and Salaries for 2014 were €3,173,582 or 99% of this category’s budget. The issue of salaries for municipal advisors paid from the budget of Goods and Services has been handled in the Chapter 4.2.

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

Recommendations

Issue 10 - Weakness in personnel management - High Priority

Finding Our review has identified several weaknesses related to personnel management. This was because the Municipality has not fully implemented the regulations for this area. Weaknesses identified are:

- Eight contracts of education personnel had expired but they are being paid. We have not been able to obtain evidence on whether the education staff are really carry out the job they receive salaries for;
- During 2014, the Municipality paid €4,359 for overtime work, but these expenditures were incorrectly recorded under the code for full time salaries;
- The Municipality has not yet implemented our advice to harmonise the salary with the contract. As a result, 114 teachers in the primary education receive gross salary by €77 less than the salary specified in the contract. In addition, 151 professors receive gross salary by €60 less than the salary specified in the contract.

Risk Weaknesses identified in personnel management result in irregular payments for salaries. Lack of evidence on work attendance is an indicator that payments were made without a legal basis. Moreover, these can be subject to fraud and serve as a base for Modification of Opinion.

Recommendation 10 The Mayor should initiate an analysis of the reasons behind irregular payments have been made, and ensure, through the Department of Human Resources, that all employees' salaries are paid pursuant to legal basis. Furthermore, salaries to all staff members who do not actively attend work should be ceased. In addition, recording should be done under appropriate codes.

4.4.4 Subsidies and Transfers

Description

In 2014, expenditures for Subsidies and Transfers were €67,166 or 55% of the final budget. The Municipality has mainly granted subsidies to non-public beneficiaries, individual beneficiaries, non-governmental organisations and businesses.

Recommendations

Issue 11 - Lack of regulation - Medium Priority

Finding The Municipality has not yet implemented our advice to adopt the regulation which would determine the criteria and procedures for granting subsidies.

Risk Lack of internal regulation on subsidies leads to the risk of subsidies being awarded without criteria and being subject to manipulation and irregular payments. This may result in the funds being spent for other purposes than those identified, thus failing to achieve the objectives of the Municipality.

Recommendation 11 The Mayor should ensure that a regulation is drafted and approved in the Municipal Assembly by the end of 2015 establishing clear criteria and procedures for granting of subsidies. In addition, effective controls should be established to ensure that approved regulations are fully adhered to.

4.5 Assets and Liabilities

4.5.1 Capital and Non Capital Assets

Description

The total value of assets disclosed in the 2014 AFS is €1,268,401. We have identified a significant risk that relates to completeness of assets register. This issue is handled in Chapter 2.2.

Issue 12 - Assets stocktaking - Medium Priority

Finding The Municipality established an Assets Stocktaking Committee for 2014 which produced a stocktaking report identifying some assets the origin and value of which was not provided. Based on the CFO request, these assets were disposed from the premises of the Municipality. We did not obtain any evidence on their condition, location or their value after the disposal. In this case, the Municipality has not implemented the Financial Rule 02/2013 on Management of Government Assets.

Risk Lack of evidence on assets disposal process may result in misuse and loss of assets.

Recommendation 12 The Mayor should provide a detailed report on the condition and location of disposed assets. The report should analyse the reasons for disposing assets without formal decisions describing the functional state, origin, quantity, and value of assets and the reasons for their disposal or alienation.

4.5.2 Handling of cash

Description

The petty cash is used for small daily spending not exceeding €100 that could have not been planned.

Issue 13 - Inadequate use of petty cash - Medium Priority

Finding During 2014, the Municipality used petty cash for official lunches. The amount paid in petty cash for official lunches was €969. This happened because the Municipality did not implement the requirements of the Financial Rule 01/2013 on Spending of Public Money.

Risk Using petty cash to pay for amounts larger than the allowed ones is a violation of the Financial Rule and may result in irregular payments.

Recommendation 13 The Mayor should strengthen controls over the spending of petty cash. Petty cash should be used exclusively for cases foreseen under the Financial Rule. All expenditures over €100 should be subject to procurement procedures.

4.6 Internal Audit System

Description

The Internal audit system is a key part of internal control and due to its importance we present it here separately. We consider the scope of internal audit work and the activity of the audit committee. In addition, we review actions taken by senior management as a result of the work carried out by internal audit and the Audit Committee.

The Municipality has established the Internal Audit Unit (IAU). This unit has prepared a strategic annual audit plan. The IAU for 2014 has planned four audits, but has carried out only one audit on revenue management.

Recommendations

Issue 14 - The IAU not operational - High Priority

Finding Our examinations on the functioning of the IAU have identified that the Municipality has not understood the internal audit role. This led to the following weaknesses:

- The IAU has not been operational as of June 2014 because the internal auditor moved to another position within the Municipality; and
- The Audit Committee has not been established.

Risk Interruption of the IAU functioning and failure to establish the Audit Committee may result in the repetition of weaknesses in key systems of internal control. The lack of internal audit reduces the Management's possibility to have an estimation of the extent internal controls operate and whether they are effective.

Recommendation 14 The Mayor should ensure that an Internal Audit System is made functional. The Audit Committee should be established so that the work of the internal audit is facilitated and contributes to the improvement of control environment. These are vital needs for the Municipality in order to obtain assurance over the effectiveness of internal control environment.

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

(extract from ISSAI 200)

Form of opinion

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

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

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

Modifications to the opinion in the auditor's report

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

Determining the type of modification to the auditor's opinion

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

The nature of the matter giving rise to the modification – that is, whether the financial statements are materially misstated or, in the event that it was impossible to obtain sufficient appropriate audit evidence, may be materially misstated; and

The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

153. The auditor should express a **qualified opinion if**: (1) having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are

material, but not pervasive, to the financial statements; or (2) the auditor was unable to obtain sufficient appropriate audit evidence on which to base an opinion, but concludes that the effects on the financial statements of any undetected misstatements could be material but not pervasive.

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

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

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

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

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

158. An Emphasis of Matter paragraph should:

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

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

Annex II: Prior Year Recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
2.2 Significant risks to the Annual Financial Statements	The Mayor/CAO should identify the appropriate action to address these control weakness in order to enable true and fair presentation of assets in 2014.			Not addressed
2.3 Compliance with AFS reporting requirements	The Mayor/CAO should ensure that the 2014 AFS production plan has addressed the areas considered with high risk of error, or areas where errors have been identified in previous years. Adequate training courses for the staff should be provided in order to make them able to record and prepare AFS according to all legal requirements and financial rules.		Partially, AFS are not yet proper relating to assets presentation	
2.4 Compliance with other external reporting requirements	The Mayor/CAO should ensure that external reporting requirements are fully met in order to achieve operations in accordance with the external reporting framework.		Partially, the self-assessment has not been carried out, and assessment of risk and financial reports (performance)	
3 Prior Year Recommendations	The Mayor/CAO should ensure that a revised action plan clearly sets out a timetable for addressing the recommendations made by the AG with accountable staff members identified and initial focus on those areas of greatest		Partially addressed, 7 completely, 3 partially and 8 were not addressed.	

	significance.			
4.1 Budget Planning and Execution	The Mayor/(CAO) should systematically monitor budget performance on a monthly basis as well as identify and address barriers to planned levels of budget execution. Where initial budget assumptions are found to be incorrect this should be fully reflected in the final budget balance.	Po		
4.2 Revenues (including Own Source Revenues)	We recommend the new Mayor/ CAO to take up a rational revenues planning approach, by approving clear collection mechanisms. A complete basis for tax payers and other debtors towards should be initially ensured.	Po		Not addressed
4.2 Revenues (including Own Source Revenues)	The Mayor/CAO should ensure that regular reconciliations of all kinds of revenues between departments are made. These reconciliations should also be made with the Treasury balance and all differences clarified.	Po		
4.3 Expenditures	The Mayor/(CAO) should ensure that the initial and final procurement plans are prepared in order to ensure that procurement processes are managed in accordance with procurement rules.			Not addressed
	The Mayor/CAO should ensure adequate supervision during the implementation of procurement process, from the process initiation stage up to the project finalisation. Weaknesses identified show that	Po		

	appropriate measures should be undertaken to improve the control over the supervision of projects within MNAO.			
	The Mayor/CAO should ensure that Procurement officers should act in accordance with the applicable Law on Public Procurement also when opening tenders, as stipulated under article 58 of LPP.	The recommendation was addressed.		
	The Mayor/CAO should ensure better planning in order that similar products are grouped for the purpose of joint tendering in order to purchase products with better prices.			Not addressed
4.3.2 Remunerations (Wages and Salaries)	The Mayor/CAO should ensure that positions of the three employees identified, which are not in compliance with set criteria, are addressed as a matter of urgency.	Po		Not addressed
	The Mayor/CAO should be cooperate with MPA for harmonisation of data relating to titles of job positions should continue in order that employees are paid according to their work positions.			Not addressed
4.3.3 Subsidies and Transfers	The Mayor/CAO should ensure that a Regulation is drafted which clearly sets forth criteria, procedures and reporting on expenditures of subsidies.			
	The Mayor/CAO should ensure that procurement rules are implemented in all cases when the budget organisation is		The Municipality has made progress but the procurement is followed with some weaknesses in	

	required to conduct procurements. In addition, while allocating subsidies, criteria for selection of subsidy beneficiaries should be applied.		2014 as well.	
	The Mayor/CAO should ensure that users submit reports on the spending of allocated funds and that every user has complete documentation. Further on, he should review the identified cases to determine why exiting criteria were not applied and introduce enhanced controls to avoid such instances occurring again.	The recommendation was addressed.		
4.4.1 Capital and non-capital assets	We recommend The Mayor/CAO to ensure that all assets owned by the MNAO are recorded completely and accurately. In addition, asset stocktaking commission should be established at the end of every year, and the stocktaking balance should be harmonised with the assets register.			Not addressed
4.6 Internal Audit	The Mayor/CAO should ensure the establishment of the AC and in the future IAU activity addresses the development and implementation of a risk based audit strategy. This should provide management with reasonable assurance that controls are well designed and operate properly.			Not addressed