



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

**Document No: 22.6.1-2014-08**

**AUDIT REPORT**  
**ON THE FINANCIAL STATEMENTS OF THE MUNICIPALITY OF**  
**PEJA**  
**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 Municipality of Peja 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 Xhevat Seferi (Team Leader) and Enver Ramadani (Member).

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## Executive Summary

### Introduction

This report summarises the key findings from our audit of the 2014 Annual Financial Statements of Peja Municipality which determine the Opinion given by the Auditor General. I would like to thank the Mayor and his team 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 13/10/2014.

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 Annual Financial Statements present *a true and fair view* in all material aspects, except the following issues:

The final budget on own-source revenues was under-stated for €226,542 and the final budget for expenditures was under-stated for the same amount; and

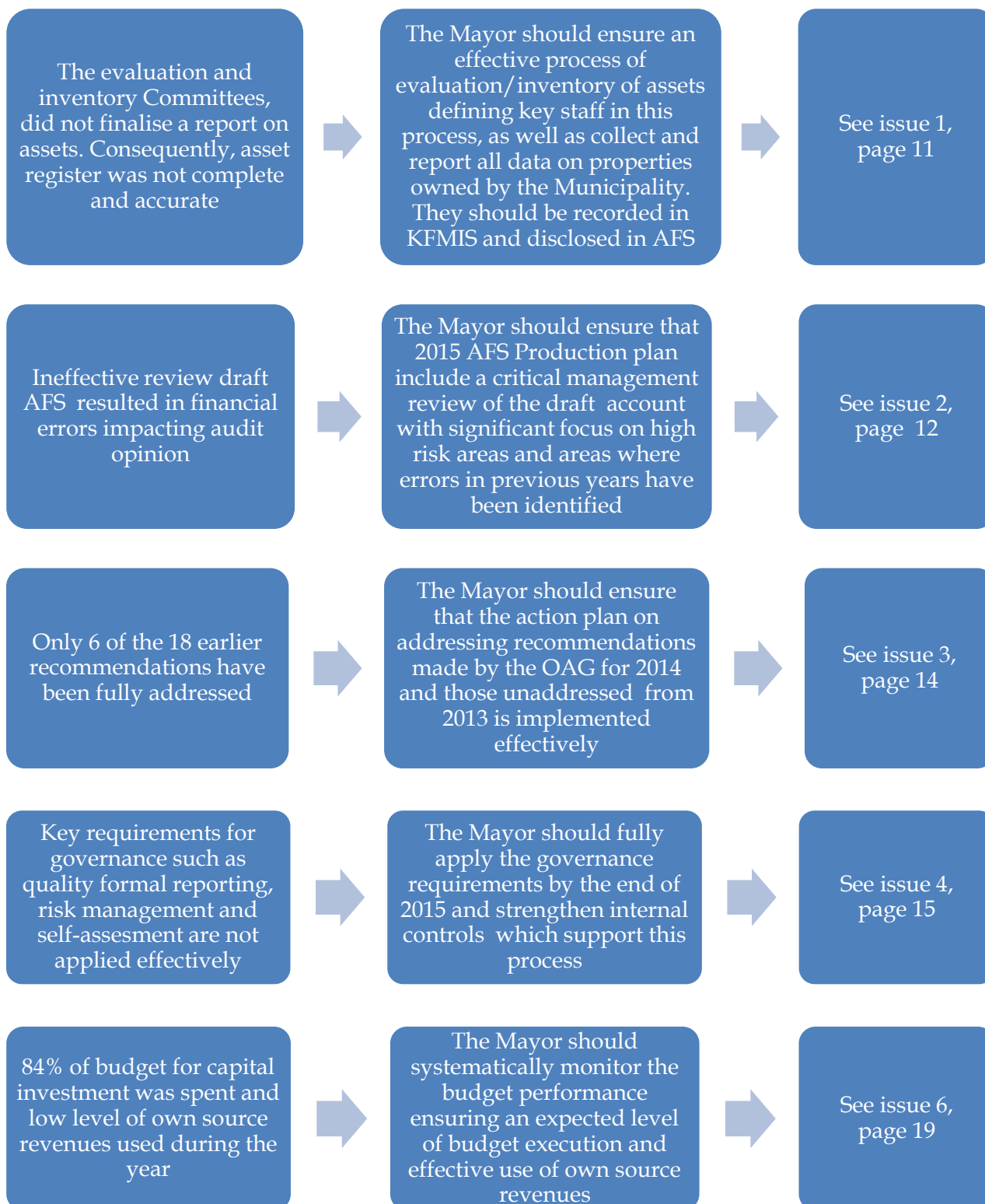
Note 12 does not contain disclosure of payments for goods and services from budget for capital investment in amount of €487,000.

As an Emphasis of Matter we would like to draw your attention to the fact that the disclosure Assets on AFS are not complete and Payments from Third Parties in amount of €142,377 were not presented on AFS

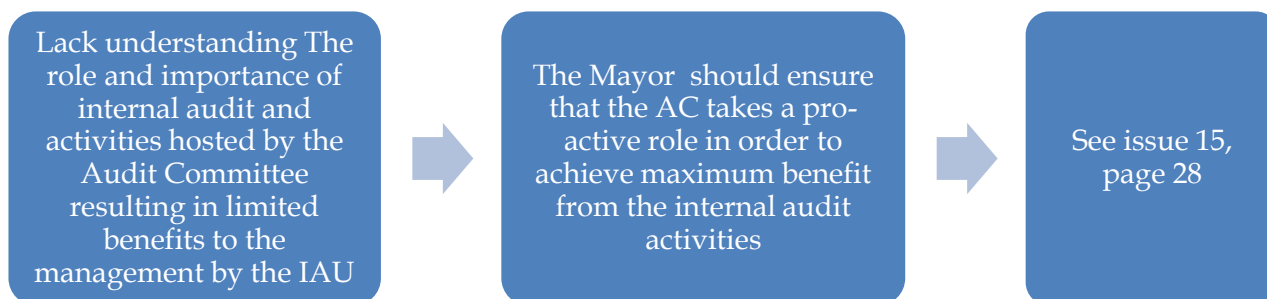
**(ISSAI 200/1705: Qualified Opinion with Emphasis of Matter).**

## 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 Peja Municipality 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

### 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 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

Peja Municipality failed to address the issue of material error concerning assets presented within the AFS. In addition, AFS of the Municipality contain a number of financial errors and there is a lack of accurate and complete disclosures. Therefore, the "Declaration" made by the Mayor and the CFO, referred above, when the AFS are submitted to the Government, was not correct in all respects. This may result in modification of the Audit Opinion.

### 2.1 Audit Opinion

In our opinion the Annual Financial Statements present *a true and fair view* in all material aspects, except the following issues:

The final budget on own-source revenues was under-stated for €226,542 and the final budget for expenditures was under-stated for the same amount; and

Note 12 does not contain disclosure of payments for goods and services from budget for capital investment in amount of €487,000

As an Emphasis of Matter we would like to draw your attention to the fact that the disclosure Assets in AFS are not complete and Payments from Third Parties in amount of €142,377 were not presented on AFS

**(ISSAI 200/1705: Qualified Opinion with Emphasis of Matter)**

## 2.2 Significant Risks to the Annual Financial Statements

### Description

Our Audit Planning Memorandum dated 13.10.2014 identified one significant risk to the AFS related to the completeness of assets. This is a risk of material misstatement that may result in a Emphasis of Matter.

### Identified Risk

#### **Issue 1 - Failure to record all assets may result in a material misstatement of assets value presented in AFS**

We reviewed management's actions and guidance applied to recording of assets. In the interim audit memo, we have provided advices to the Management on the actions required to ensure that assets presented within Annual Financial Statements are complete. However the risk identified has materialised because Committees for recording and valuation of assets were established with delay and no progress was made by the time of audit. Consequently, assets records and their value presented in the annual financial statements is not complete.

The Minister should analyse the reasons for the 2014 Emphasis of Matter and identify the action required to address these controls weaknesses to enable a true and fair presentation of Assets in 2015 AFS.

**Recommendation 1 High Priority** - the Mayor should ensure an effective process of recording all assets, defining key roles that in this process could be Cadastre Directorate, collect and report all data on properties owned by the Municipality. Further on, a special Committee should evaluate the assets identified and, a report is submitted to the Asset Officer for processing appropriate recording into KFMIS system (module assets) following the critical review by the Mayor. Further on, Asset Inventory and Evaluation Committees should be established annually within appropriate timeliness to carry out an inventory and confirm the existence of assets (in particular tangible assets). All activities should be carried out before the AFS 2015 are submitted.

## 2.3 Compliance with AFS and other reporting requirements

### Description

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

- Compliance with Financial Rule no. 03/2013;

- Requirements of LPFMA no. 03/L-048;
- Budget requests;
- Quarterly reports including nine month financial statements in time;
- Operational (annual performance) reports; and
- Draft and final procurement plans in time.

In the context of other reporting requirements, they were fully met with the exception of Performance Report 2013 which was not prepared and published. Such practice may be repeated in 2014 as well.

Despite the adjustments made to some non-material errors in the draft AFS, the final AFS contain a number of financial errors as seen below.

## **Issue 2 - AFS Preparation - High Priority**

### **Finding**

The Management did not implement an effective review process in terms of preparing the AFS which resulted in the following errors:

- payments by third parties in the amount of €142,377 are not presented in the statement of receipts and payments;
- In the Statement of budget execution, the final budget for own source revenues is understated by €226,542 and at the same time the final budget for expenditures was understated by €226,542; Further on, the final budget for donations was overstated by €1,300;
- Numbers of disclosures are not harmonised with the numbers of notes in the first statements;
- payments for goods and services from the budget for capital investments in the amount € 487,000 were not disclosed in Note 12;
- Note 30 (summary of capital assets) the value of Municipality's assets is not complete (see issue 1); and
- Note 34, receivables are understated by €87,893.

Considering what has been said above, 'Declaration' made by the Mayor and CFO, when draft AFS are submitted to the Government, can be considered incomplete and inaccurate.

**Risk** The absence of an effective review of the AFS by the high level of management resulted in material errors which could lead to a modified opinion. Further on, AFS involving errors could be considered as unreliable, resulting in damage to credibility in the financial reporting by the Municipality.

**Recommendation 2** The Mayor should ensure that the 2015 AFS production plan includes management's critical review of the draft account with specific focus on high risk areas and/or areas where errors have been identified in previous years. The Declaration made by the Mayor and CFO should not be submitted unless all necessary checks have been applied to the draft AFS.

### 3 Prior Year Recommendations

#### Overall Conclusion

Despite preparing an Action Plan to address the recommendations 2013, a number of important issues remain to be addressed.

Our Audit Report on the 2013 AFS resulted in 18 key recommendations. The Municipality prepared an Action Plan stating how all recommendations will be addressed.

At the end of our 2014 audit, only six (6) recommendations have been fully addressed; five (5) are partially addressed; and seven (7) have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II.

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#### Issue 3 - Addressing Prior Year Audit Recommendations - High Priority

**Finding** Only a proportion of prior year recommendations have been implemented. The Municipality has not implemented any formal process to manage and monitor the implementation of AG's recommendations in line with prepared Action Plan.

**Risk** Failure to fully address recommendations resulted in continued weaknesses in key financial systems with special emphasis on:

- Shortcomings in Asset register;
- low level of execution, especially in capital investments;
- Continued weaknesses in managing own source revenues;
- Continued weaknesses in expenditures through procurement and poor value for money; and
- Limited benefit from internal audit.

**Recommendation 3** The Mayor should ensure that an action plan clearly sets out a timetable for addressing the recommendations made by the AG and those not addressed from 2013 with accountable staff members identified. Initial focus on those of greatest significance. Progress against the plan should be directly monitored by the Mayor.

## 4 Governance

### Overall Conclusion

Strong governance supports effective planning, implementation and monitoring of activities of the Municipality.

The key aspects to be addressed in order to enable proper governance are:

- Risk management, where the Municipality did not establish formal and documented procedures for minimising the risk against operational and strategic objectives of the Municipality;
- Self-assessment, where the Municipality did not meet the FMC requirements for self-assessment;
- Effective and systematic monitoring of activities where current reporting does not provide a formal basis for management of revenues and expenditures; and
- Internal audit system - there is poor communication with the Management and as a result, no meeting between them was held to discuss the issues raised by the audit.

### 4.1 Good Governance

#### Description

Procedures of good governance are intended to confirm that management implemented a range of internal controls to ensure that financial systems operate as intended. It is important that they include the proper reporting to Management enabling an effective and timely response to the operating and financial identified challenges.

#### Recommendations

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##### Issue 4 - Overall Governance Arrangements - High Priority

#### Finding

Our review of the high management controls applied to the Municipality key financial system highlighted poor control over expenditures and revenues. This is because the format of management reports does not provide explanations for variances against budget and execution.

FMC requirements for applying self-assessment and formal risk management are not addressed at all because the Municipality did not fully recognize their importance as tools supporting effective management.

Although there is an Audit Committee in place, the contribution of this Committee for good governance arrangements has been minimal. This Committee did not take any significant activity during 2014 due to the lack of importance that the Municipality has given to this Committee.

**Risk** Poor accountability requirements and poor quality financial reporting reduced the efficiency of financial and operational management in the Municipality and may result in poor value for money and/or possible financial loss. Lack of effective Audit Committee reduces the focus and impact of internal audit activity and reduces the assurance that the internal audit provides to the Management.

**Recommendation 4** The Mayor should review current governance arrangements and related reporting requirements. Unfulfilled requirements should be addressed until the end of 2015. The quality of related issues, such as internal reporting, should be critically reviewed in order to document that effective actions have been implemented securing effective operational management of the Municipality and that strategic objectives are met.

#### **Issue 5 - Avoiding open procurement procedures - Medium Priority**

**Finding** During 2014 the Municipality carried through 128 procedures using price quotation for supplies with minimum value (€55,025) and supplies with small value (€397,514). The following are two cases where open procurement procedure could have been used:

- The Municipality made 15 payments with the minimum value of €12,751 for school maintenance although there was a contract in place (€235,112) for such work executed using open procedures; and
- Seven (7) contracts were signed using quotation price (€47,844) for renovation, plastering and dyeing of facilities. Four of them were signed with the same Economic Operator.

**Risk** The Municipality does not apply proper procurement procedures. Using quotation procedure for expenditures which could be made using open procedures, increases the risk for poor value for money, it eliminates competition and may be subject to fraud.

**Recommendation 5** The Mayor should analyse the reasons behind such a high number of quotations, with particular emphasis on cases where for some expenditures there is a contract with open procedures. The Mayor should strengthen controls on procurement planning and implementation securing that open procedures are used for expenditures of the same nature to achieve the highest value for money paid.



## 4.2 Budget Planning and Execution

### Description

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 budget Funds - outturn against the budget (in €)**

Description	Initial Budget	Final Budget <sup>1</sup>	2014 Outturn	2013 Outturn	2012 Outturn
<b>Sources of Funds</b>	<b>19,208,665</b>	<b>22,024,482</b>	<b>20,536,683</b>	<b>20,263,384</b>	<b>18,970,438</b>
Government Grant -Budget	16,163,665	17,567,773	17,232,343	16,980,919	15,930,094
Carried forward from previous year <sup>2</sup> -	0	665,509	659,067	650,615	668,228
Own Source Revenues <sup>3</sup>	3,045,000	3,271,542	2,566,106	2,456,879	2,121,449
Domestic Donations	0	72,557	0	4,500	6,560
External Donations	0	447,101	79,167	170,469	244,107

The final budget is higher than the initial budget by €2,815,818. This increase is a result of:

- Increase of Government grant in the amount of €1,404,108
- Increase of Own Source Revenues in 2014 in the amount of €226,542
- Own Source Revenues carried forward from 2013 in the amount of €665,510;
- Domestic donations in the amount of €72,557; and
- External donations in the amount of €447,101.

In 2014 the Municipality spent 93% of the final budget similar to the previous year. Budget execution is at relatively satisfactory level and explanations for the current position are detailed below.

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

<sup>2</sup> Own Source Revenues unspent in previous year carried forward into the current year.

<sup>3</sup> Receipts used by the entity for financing its own budget.

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
<b>Spending of funds broken down by economic categories</b>	<b>19,208,665</b>	<b>22,024,482</b>	<b>20,536,683</b>	<b>20,263,384</b>	<b>18,970,438</b>
Wages and Salaries	10,549,983	11,998,581	11,925,237	10,482,665	10,378,157
Goods and Services	2,438,219	2,549,360	2,260,801	2,705,611	2,686,923
Utilities	611,914	611,914	528,460	597,009	557,083
Subsidies and Transfers	350,000	430,139	428,300	599,233	473,692
Capital Investments	5,258,549	6,434,488	5,393,885	5,878,865	4,874,583

Explanations for changes in budget categories are given below:

- The Budget for Capital investment was increased by €1,175,939, while the level of expenditures for this category was only 84% of the budget or 8% less than in previous year, which represents an unsatisfactory budget performance. Furthermore, the amount of €146,000 from the capital investments budget was paid for services and €469,819 were executed under Article 39.2 of LPFMA on outstanding liabilities against suppliers. This is due to the lack of controls to carry through a proper planning and contract management. Consequently, some projects have not started at all, and some others have been delayed in terms of works' execution;
- Increase of budget for Wages and Salaries by €1,468,598 is due to the Government's decision to increase the salaries by 25%;
- The budget for Goods and Services was increased by €111,141 while the level of expenditures was 89% of the final budget. The Municipality failed to undertake any formal action for managing budget cuts from the Goods and Services (15% under government decision). This increase resulted in outstanding liabilities in the amount of €30,000 for Goods and Services and €70,000 for Utilities. This level of budget execution reflects the lack of a budget planning based on real needs and opportunities of the Municipality; and
- The total amount of donations (domestic and external) was €519,658, while only 15% was spent. This occurred due to poor performance by the Municipality to use donations which had a negative impact on fulfilment of the Municipality's plans.

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
Own source revenues	3,045,000	3,271,542	3,271,418	3,003,047	2,727,094

The initial plan for collection of own source revenues in 2014 was exceeded by 7%. Compared with the previous year, the Municipality collected 9% more revenues or 20% more than in 2012. The increase of revenues in 2014 was largely as a result of increased tax revenues from the Cadastre,

administrative fees, and doubling of revenues from traffic fines and penalties by the courts. The amount of €2,725,087 was collected by the Municipality, whilst €546,331 are revenues from traffic fines and courts.

## Recommendations

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### Issue 6 – Budget Execution – High Priority

**Finding** The Municipality shown poor budget performance in the category of capital investments (84%). 11% of expenditures relate to payments for services and obligations from previous years, reflecting that only 73% of capital investments were spent during the year. This is due to lack of planning and systematic control of the municipal budget.

Due to the low level of using own source revenues, 18% or €711,879 were carried forward to be spent in 2015. Similar occurred with the budget from donations where only 15% from 519,658 were spent during 2014. This reflects poor planning.

**Risk** Poor budget planning and execution reduces the effectiveness of municipal plans and results in failure to achieve the objectives. The low level of use of the budget could result in reducing government grants and loss of donations in the future. Overstatement of expenditures for capital investments leads to misunderstanding of the financial position of the Municipality and may result in modification of the opinion.

**Recommendation 6** The Mayor should ensure that budget performance is systematically monitored on monthly basis securing an expected level of budget execution and effective use of own source revenues. All expenditures should be planned and classified in appropriate codes/ categories and correctly disclosed in AFS 2015.

## 4.3 Revenues (including own source revenues)

### Description

The main sources of Own Source Revenues of the Municipality are property tax, construction licenses, co-payments, vehicle registration fees and other administrative fees. The Municipality also collects revenues from courts, traffic fines and forest use and property use licenses.

## Recommendations

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### Issue 7 - Weaknesses in revenue planning, collection and reporting – High Priority

#### Finding

Our review has identified a number of weaknesses in Municipality management of revenue collection. These are described below:

- **Property Tax** – Planned revenues from Property Tax in 2014 were in amount of €1,270,000 whereby €1,405,213 or 11% in excess of the plan were collected. This does not represent a real performance since the planned amount is lower than the invoiced one (€1,771,510). The invoiced amount was 28% higher than the planned one. Such planning, although partly determined by the budget circular ceilings, mirrors a weak and unfounded projection for this type of revenue.
- **Construction permits** – Plans were to collect €250,000 from Construction permits whilst €267,533, including collection for prior year invoices, were in fact collected. Year- on- year (577,562€), collection from Construction permits dropped for 115%. The Municipality was not able to provide an explanation for the decline;
- **Revenues from leasing** – The Municipality managed to collect only €26,671 or 48% of the /invoiced amount from lease. This was a consequence of ineffective review of these revenue by the management; and
- **Maintaining a database and reporting** – Collection and reporting of revenue from health co- participation is done manually although the Municipality owns software for collection of revenue up to €10. The database on payment of fees in pre-school institutions is maintained in hard copy only. The Directorate for Cadastre is not reporting and reconciling regularly the revenue to the revenue officer. The library “Azem Shkreli” generates revenue from readers’ membership fee, nevertheless these are not timely deposited in the bank. This was a consequence of Municipality failure to comply with the regulations on collection and reporting of revenues.

#### Risk

Poor planning of revenue affects the overall budget planning projections, particularly the capital investments whilst poor revenue collection may result in reduced investments by the Municipality. Manual maintenance, absence of reporting and delays in depositing revenues to the bank may result in potential financial lose and may be subject to fraud.

**Recommendation 7** The Mayor should initiate an analysis the reasons leading to significant discrepancies between revenue planning, collection and invoicing. One should consider the trend of revenue over the past years whilst application of poor controls in the management aspect (carrying forward revenue in the following year) needs to improve. In addition, controls need to be strengthened to ensure that all Municipality institutions collect the revenue envisaged by law and report and deposit them to the Municipality account. An appropriate solution should be introduced by the end of 2015.

## 4.4 Expenditures

### 4.4.1 Procurement

#### Description

Procurement rules are intended to ensure that public funds reach value for money through transparent and efficient application. The legal framework clearly defines the rights, duties and responsibilities of all stakeholders involved in public procurement. It includes also requirements to reduce the risks relating to delays in the completion of the works, avoidance of conflicts of interest and incomplete bids as well as achieving value for money.

In 2014, a total of 200 procurement procedures in amount of €4,129,666 were applied.

#### Recommendations

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#### Issue 8 – Weaknesses in expenditures through procurement- High Priority

**Finding** Our review has identified several weaknesses in expenditures through procurement. These have occurred due to the lack of effective review by management and the failure to apply the procurement rules. Identified cases are presented below:

- For the project “Construction of the “Adrian Kelmendi str”, “Qerim Begu str” and paving cobblestones in the “Ilmi Malushi str” an certificate attesting ownership over a asphalt plant was required whilst the economic operator submitted only an expired one. The Municipality awarded him the contract worth €48,376;
- Submitting the supply price according to the average stock exchange price was required for contracted fuel supply, whilst the economic operator had applied prices according to the supply invoice, plus the premium, and not according to the price movements in international stock exchanges;

- Transportation of students with special needs in amount of €3,035 was done with an agreement, avoiding the procurement procedures;
- The Municipality had paid an invoice in amount of €24,809 for the project “Construction of the physical education hall in the High School “Bedri Pejani in Peja”, co- funded with the Ministry of Culture, although the invoice did not describe performed works and the progress payment report was not signed by the project supervising authority; and
- The Municipality planned €30,000 for public lighting maintenance whilst the costs incurred were in amount of €53,759. In addition, €40,000 were planned for maintenance of the cemetery, whilst the costs incurred were in amount of €52,844. The excess was paid from the budget of other projects.

#### **Risk**

Awarding contract to the economic operator without meeting the tender criteria or avoiding procurement procedures, except it is inconsistent with the legal requirements, may result in poor quality works/supplies and poor value for money. Payment for works without the signature of the supervising authority does not confirm the execution of works and can result in irregular payments. Exceeding the budget for planned expenditures could result in delays or failure of other planned projects.

#### **Recommendation 8**

The Mayor should ensure that procurement controls are strengthened during tender evaluation and acceptance of works and supplies to ensure that payments are made only for works/supplies rendered that meet the quality requirements. No contract should be offered to operators who do not meet the tender criteria. On the other hand, all expenditures that require procurement must be subject of appropriate procurement procedures to ensure value for money. The Mayor should ensure that the needs assessment is done based on adequate analysis to avoid excesses in planned expenditure.

## **4.4.2 Non Procurement Expenditure**

### **Description**

Procurement expenditures not requiring procurement relate to goods and services which do not require procurement. Examples of these expenditures are utilities, travel advances, official lunches petty cash expenses, a part of co-financing etc. There are some aspects of non-procurement expenditures which controls were not applied effectively.

## Recommendation

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### Issue 9 - Co-financing payments - High Priority

**Finding** The Municipality transferred the amount of €12,000 respectively €7,362 to the account of the two organizations, IOM and the "Rotary Club" based on co-financing agreement for the project "participation in projects with the community, donors and the minister". The payments were made up front in accordance with the agreements at the same time as no requirement on reporting of results and finances during the implementation stage were set.

**Risk** Upfront payments not supported by effective contracts may result in financial loss for Municipality. Lack of reporting during the project implementation may result in the non-achievement of objectives and may potentially be considered as irregular payments.

**Recommendation 9** The Mayor should revisit the rationality behind the practice of entering into contracts and carrying out upfront payments long before the start of the projects. Furthermore, agreements should ensure appropriate reporting of finances and results during the implementation stage forming for a base for monitoring. Final reports should be published ensuring transparency and accountability.

## 4.4.3 Remunerations (Wages and Salaries)

### Description

Wages and salaries are paid through a centralised government system. Controls operating locally by the Municipality relates to: a) the authorisation of the payroll; b) verification of the possible changes; and c) review the budget for this category and reconciliation with the Treasury.

### Recommendations

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### Issue 10 - Recruitment procedures - High Priority

**Finding** Our review of recruitment procedures identified the following weaknesses:

- An advertisement dated 29.03.2014 was cancelled by the labour inspectorate and one of the reasons was failure to document verbal test answers by candidates. On 15.09.2014 the Municipality re-adverted this competition for five (5) dentists. Again the verbal test documentation was not in place. Furthermore, six (6) candidates were hired under this advertisement. This occurred because the Municipality did not implement regulations for recruitment; and

- Two advertisements for the Directors of Educational Institutions and three advertisements for teachers were held in absence of the Selection Committee's list, the list of candidates who have applied, the short list of candidates, and the qualifying list to be sent to the Mayor for approval. This case reflects the violation of recruitment regulations.

**Risk** Violations of recruitment procedures are in contradiction with the principle of equal treatment of candidates and may result in hiring unqualified staff and not qualitative services to the citizens.

**Recommendation 10** The Mayor should initiate an analysis of the reasons behind why recruitment procedures in identified cases are not considered and ensure that these will remain as isolated cases. Controls during the recruitment should be strengthened and the process should be monitored by the Mayor to ensure that only candidates that meet criteria set are hired.

#### **Issue 11 - Irregular Salaries - High Priority**

**Finding** In March 2014, the Mayor appointed a director of Main Family Medicine Centre (MFMC) without an advertisement and without employment contract. Independent Oversight Board for Civil Servants on 20.11.2014 decided to cancel the recruitment of MFMC Directorate, and obligated the Municipality within 15 days to implement the decision. This decision was not implemented, and the salary was paid up to December 2014. This occurred because the Municipality did not apply the recruitment rules.

Salaries for education staff for March/August 2014 include unpaid salaries from previous years in the amount of €10,447 for regular held classes, informal learning and additional work. The Municipality was not able to provide sufficient evidence on the regularity of these salaries for the past years. This was due to poor management review of expenditures for salaries.

**Risk** Title and payments to Directors without advertisement and without a contract, and payment of salaries from previous years without sufficient evidence, insufficiently to confirm the basis of the regularity of payments. As such, these payments may result as unfair and cause financial loss to the Municipality.

**Recommendation 11** The Mayor should ensure a review the decision for appointment of the Director of Family Medicine and ensure that all recruitments are made fully in compliance with legal requirements. The controls on payment of teaching staff should be strengthened to ensure that all payments are supported by sufficient evidence in accordance with the financial rules.



#### 4.4.4 Subsidies and Transfers

##### Description

The main types of subsidies granted by the Municipality for student and pupils scholarships, subsidies for sports, social assistance cases, subsidies for agriculture, etc. The Municipality has internal regulation for granting subsidies, based on which the criteria for granting is established.

##### Recommendations

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##### Issue 12 - Weakness in managing subsidies - High Priority

##### Finding

Our review identified some weaknesses in granting subsidies which occurred due to the lack of effective review and non-execution of the Internal Regulation and financial rules. These weaknesses are as follows:

- The Municipality subsidised FC "Peja" in amount of €7,000 without any project/detailed plan on how the expenditure of funds. Furthermore, the beneficiary did not report to the Municipality for way and purpose these funds were spent;
- A similar case occurred with a subsidy granted in the amount of €6,000 for the village of Jablanica e Madhe for building cemetery fences; and
- Internal Regulation foresees that a beneficiary may receive subsidies only once during the year. The Municipality subsidised several times FC "Besa" in total amount of €15,000 and the NGO "Youth Centre Peja" in total amount of €21,608. Furthermore, the coordinator and signee of the agreement by the NGO "Youth Center Peja" was an officer in the Department of Culture, Youth and Sports.

##### Risk

Lack of projects/plans for financing activities and lack of reporting of expenditures from funds received as subsidies, could result in potentially improper payments and failure to achieve the intended objectives. Signing the agreement on subsidies by municipal official presents potential conflict of interest.

**Recommendation 12** The Mayor should ensure a review the controls for granting subsidy processes in order that all expenditures for subsidies will be carried out in accordance with the internal regulations and contribute to achieving the objectives of the Municipality. All beneficiaries should provide a feedback to the Municipality securing value for money and avoiding the possibility of fraud. The Mayor should ensure that possible cases of conflict of interest will be avoided and will not be repeated in the future.

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## 4.5 Assets and Liabilities

### 4.5.1 Capital and Non Capital Assets

#### Description

Asset management in the Municipality is accompanied by ongoing weaknesses. Asset inventory committee was established with delay and as a result by the end of our audit did not complete the work.

We have identified the completeness of the Municipality's as a significant risk and as such is handled in Chapter 2.2 (see issue 1).

### 4.5.2 Handling of Receivables

#### Description

The Municipal receivables represent the amount of funds that citizens and organizations owe the municipality for services, works, goods or properties that have benefited from the municipality.

#### Recommendations

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#### Issue 13 - Systematic increase of receivables - High Priority

**Finding** The amount of receivables at the end of 2014 amounts to €15,039,448, out of which the lion share relates to property tax (€8,473,170) and other business licenses (€6,457,680), then leasing (€11,920), participation by preschool institutions (€8,785), and the use of advertising panels (€83,348). Continued increase of these accounts occurred because the Municipality failed to establish effective mechanisms for their collection. Furthermore, the Municipality still has no strategy on actions to be taken for the collection of receivables.

**Risk** Increased receivables reduce the ability of the Municipality to finance projects from own source revenues and may encourage other debtors not to pay their obligations to the Municipality.

**Recommendation 13** The Mayor should initiate an analysis the reasons for high level of receivables and strengthen controls to prevent their further increase. A strategy and adequate mechanisms should be introduced to enable the collection of historic receivables, including legal actions.

### 4.5.3 Handling of Debts

#### Description

The Municipality's debts represent the Municipality's liabilities towards the suppliers and its employees as well. The increasing trend of debts year after year is also noticed in Peja Municipality, reflecting improper management of budget activities.

The Municipality's Statement of Liabilities for 2014 shows liabilities of €609,000. This amount consists of liabilities of €409,240 for Goods and Services, €180,691 Utilities and €18,879 Capital Investments.

This year the Municipality has entered into outstanding liabilities due to lack of effective management of budget cuts with 15% for Goods and Services (see section 4.2).

#### Recommendations

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#### Issue 14 – High levels of debts in the Municipality – High Priority

**Finding** The Municipality did not manage to establish effective review for keeping the level of debts under control. As a result, debts have continuously increased. The amount of €469,819 was executed according to Article 39.2 of the LPFMA in 2014 to pay outstanding liabilities to suppliers. However, this reflects only a part of the budgetary challenge as the Municipality has contingent liabilities of €921,860 that may turn into final liabilities, thus worsening the budget situation in the Municipality.

**Risk** The high level of outstanding liabilities and increase in contingent liabilities increases the risk for the Municipality's budget being subject to direct execution by MoF and court decisions (as it was the case in 2014). Such a situation may lead the Municipality to a difficult financial position that may result in projects failure to be delivered and other irregularities in financing key activities.

**Recommendation 14** The Mayor should strengthen management controls by providing a detailed and real budget planning and ensure that funds are used based on a clear cash flow plan and by not exceeding in any case the funds allocated by economic categories. In order to handle accumulated debts, the Mayor should introduce a plan setting forth concrete actions for the gradual settlements of debts. The Mayor should directly monitor this plan.

## 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 Internal Audit Unit (IAU) planned 12 audits for 2014 and fulfilled the plan. The areas covered by Internal Audit are: 1) Procurement process (for 2013); 2) Revenues and expenditures Management (for 2013); 3) Revenues and expenditures management, adherence to the laws and regulations when issuing construction permits (for 2012/2013); 4) Revenues and expenditures in Cadastre Directorate (for 2013); 5) Revenues and expenditures (for 2013/first quarter of 2014); 6) Expenditures of Mayor's Office (for 2013); 7) Revenues and expenditures in the Directorate for agriculture, forestry and rural development (for 2013/first half of 2014); 8) Revenues and expenditures management, adherence to the laws and regulations on fees, tariffs, duties and fines (for 2013/first half of 2014); 9) Revenues and expenditures in the Directorate for culture, youth and sports (for 2013/January-August 2014); 10) Revenues and expenditures in the Directorate for Education (for 2013/January-June 2014); 11) Revenues and expenditures in the Directorate for Health (January-October 2014); and 12) Revenues and expenditures management (for 2014).

While examining IAU work, we could not rely on the internal audit work in order to reduce our audit work. This was because our objectives, testing approach and audit coverage did not fully match.

### Recommendations

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#### Issue 15 - Weaknesses in internal audit - High Priority

<b>Finding</b>	<p>Our review has identified weaknesses in the internal audit system. These are presented as follows:</p> <ul style="list-style-type: none"><li>• A small number of audits has covered the current year 2014;</li><li>• The Management does not prepare action plans for addressing Internal Audit Unit (IAU) recommendations. As a result, half of 64 recommendations given were addressed;</li><li>• There is poor communication between IAU and Management. As a result, no meeting was held during the audit to communicate and discuss about the weaknesses identified; and Audit Committee (AC) held regular quarterly meetings where they discussed the IAU reports and asked management to implement the recommendations given by the IAU</li></ul>
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**Risk** Failure to recognise the IAU role and significance will result in limited benefit to the Management for obtaining assurance on internal control environment. Lack of action plans will result in continued weaknesses in key financial and operational activities of the Municipality leading to potential financial loss and poor value for money.

**Recommendation 15** The Mayor should ensure that the AC takes a pro-active role in order to obtain maximal benefits from internal the audit system. AC should critically review the sources, plans, and results of IAU and contribute to the overall improvement of the Municipality's management. The Mayor should establish regular communication with IAU in order to prevent errors and mistakes in the Municipality's financial and operational systems.

## 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

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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 1705<sup>19</sup> 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	Recommendations given	Fully addressed recommendations	Partially addressed recommendations	Unaddressed recommendations
2. 2 Significant risks to the Annual Financial Statements	The Mayor should identify the right action to address these control weaknesses in order to enable a true and fair presentation of assets in 2014.			Not addressed
3 Prior year recommendations	The Mayor should ensure that a revised action plan clearly sets out a timetable for addressing the recommendations made by the AG with accountable staff members identified and with initial focus on those of greatest significance. Implementation of this plan should be monitored by the Mayor on monthly basis.		Partially	
4.3 Own Source revenues (including own source revenues) Issue 3 – Property tax	The Mayor should ensure that a Strategic Plan on the collection of receivables and the management of this process is put in place. A preliminary assessment should be made, (given the known complexity of the existing operations), and a way of increasing own source revenues collection level should be found.			Not addressed
4.3 Own Source revenues (including own source revenues) Issue 4–Non reconciliation of revenues from municipal departments	Mayor should ensure that the municipal departments and the Revenues Officer reconcile revenues on a regular basis in order to provide completeness and accuracy of revenues		Partially	
4.3 Own Source revenues (including own source	The Mayor should, as soon as possible, plan how to handle the account receivables from business operation	Yes		

revenues) 5 - Business operation tax	tax accumulated over the years.			
4.3 Own Source revenues (including own source revenues) Issue 6 - Revenues from secondary education	During the interim period, we have advised the management to stop receiving cash of over €10 (out of the bank account). At the final stage, we obtained assurance that the advice given had already started to be implemented. We do encourage the management to continue carry on with such practice	Yes		
4.3 Own Source revenues (including own source revenues) Issue 7 - Revenues from health co-payments	The Mayor should take measures as soon as possible to ensure that amounts over €10 are paid into municipality's bank account authorised by the Director of Treasury.	Yes		
4.3 Own Source revenues (including own source revenues) Issue 8 - Revenues from leased out premises	The Mayor should implement a registration process of all properties and associated charges, which should be reviewed regularly.			Not addressed
4.4 Expenditures (procurements) Issue 9- Systematic weaknesses in procurement	The Mayor should analyse why procurement requirements were not addressed in these cases and ensure that enhanced controls are implement to ensure that such situations are not repeated.		Partially	
4.4 Expenditures (procurements) Issue 10 - Weaknesses in implementing contracts	The Mayor should ensure an effective control system on the whole procurement process up to the complete contracts implementation. Proactive actions should be undertaken to prevent departures from contract terms when goods are received and goods prices are paid		Partially	
4.4 Expenditures (procurements)	The Mayor should put effective controls over this area in place as soon as possible in order that vehicles are used	Yes		

Issue 11- Weaknesses in vehicle Management	after the request for driving services has been filled out and approved.			
4.4.3 remunerations( wages and salaries) Issue 12- Incomplete personnel files	The Mayor should ensure that Human Resources Department will update all personnel records on regular basis, including employment contracts.		Partially	
4.4.4 Subsidies and Transfers Issue 13 – Decision on subsidies without funds	The Mayor should stop this phenomenon and, in the future, should not take decisions prior to have an approved budget. Subsidy should only be granted when funds are available and in line with the Regulation on subsidies.	Yes		
4.4.4 Subsidies and Transfers Issue 14 – Subsidising public entities	The Mayor should ensure that agreements with the beneficiaries are implemented by obliging them to report in accordance with the agreement signed. Municipality’s Regulation on Subsidies should be implemented and the municipality should ensure that subsidies have reached the intended purposes.			Not implemented
4.5 Assets and Liabilities Issue 15 – Asset recording	The Mayor should ensure that concrete actions are taken to enable immediate recording of all assets in the respective registers in accordance with requirements of AI, and that correct and complete assets are reported. In addition, the assets stocktaking should be completed at the year-end in order to prove the physical existence of all assets on the stocktaking day.			Not implemented
4.5.2 Handling of receivables Issue 16 – Increase of receivables	The Mayor should have a comprehensive approach in handling revenues, both at the planning stage and in putting effective mechanisms in place for the accomplishment of planned parameters.			Not implemented

	The management should initiate a reassessment process, where all accounts will be analysed in terms of aging, significant amounts, real possibilities for collection and the exercise of administrative measures.			
4.6 Handling of debts Issue 17 – Entering into obligations beyond AFS	The Mayor should ensure that the Municipality will not enter into liabilities by exceeding the budget and by risking the upcoming year’s budget.	Po		
4.7 Internal Audit system Issue 18 – Internal Audit	The Mayor should ensure that IAU’s audit plan includes current year processes/activities in order to assist the management in taking decisions in time and to prevent eventual errors.			Not implemented