



Republika e Kosovës  
Republika Kosova  
Republic of Kosovo



Zyra Kombëtare e Auditimit  
Nacionalna Kancelarija Revizije  
National Audit Office

**Document No: 22.32.1-2017-08**

**AUDIT REPORT**  
**ON THE ANNUAL FINANCIAL STATEMENTS OF MUNICIPALITY**  
**OF JUNIK FOR**  
**THE YEAR ENDED 31 DECEMBER 2017**

**Prishtina, June 2018**

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

Our Mission is through quality audits strengthen accountability in public administration for an effective, efficient and economic use of national resources.

We perform audits in line with internationally recognized public sector auditing standards and good European practices.

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

The Auditor General has decided on the audit opinion on the Annual Financial Statements of the Municipality of Junik, in consultation with the Assistant Auditor General, Valbon Bytyqi, who supervised the audit.

The report issued is a result of the audit carried out by Ilir Abazi, (team leader) and Arben Hundozi, (team member) under the management of the head of audit department Mujë Gashi.

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## Executive Summary

### Introduction

This report summarises the key issues arising from our audit of the 2017 Annual Financial Statements of Municipality of Junik, which determines the Opinion given by the Auditor General. The examination of the 2017 financial statements was undertaken in accordance with the International Standards on Supreme Audit Institutions (ISSAIs). Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The applied audit approach is set out in our External Audit Plan dated 24/11/2017.

Our audit focus has been on:



The level of work undertaken by the National Audit Office to complete the 2017 audit is determined depending of the quality of internal controls implemented by the Management of the Municipality of Junik.

The National Audit Office acknowledges Municipality's Senior Management and Staff for cooperation during the audit process.

### Opinion of the Auditor General

#### **Unmodified Opinion with Emphasis of Matter**

The Annual Financial Statements for 2017 *present a true and fair view* in all material aspects.

#### **Emphasis of matter**

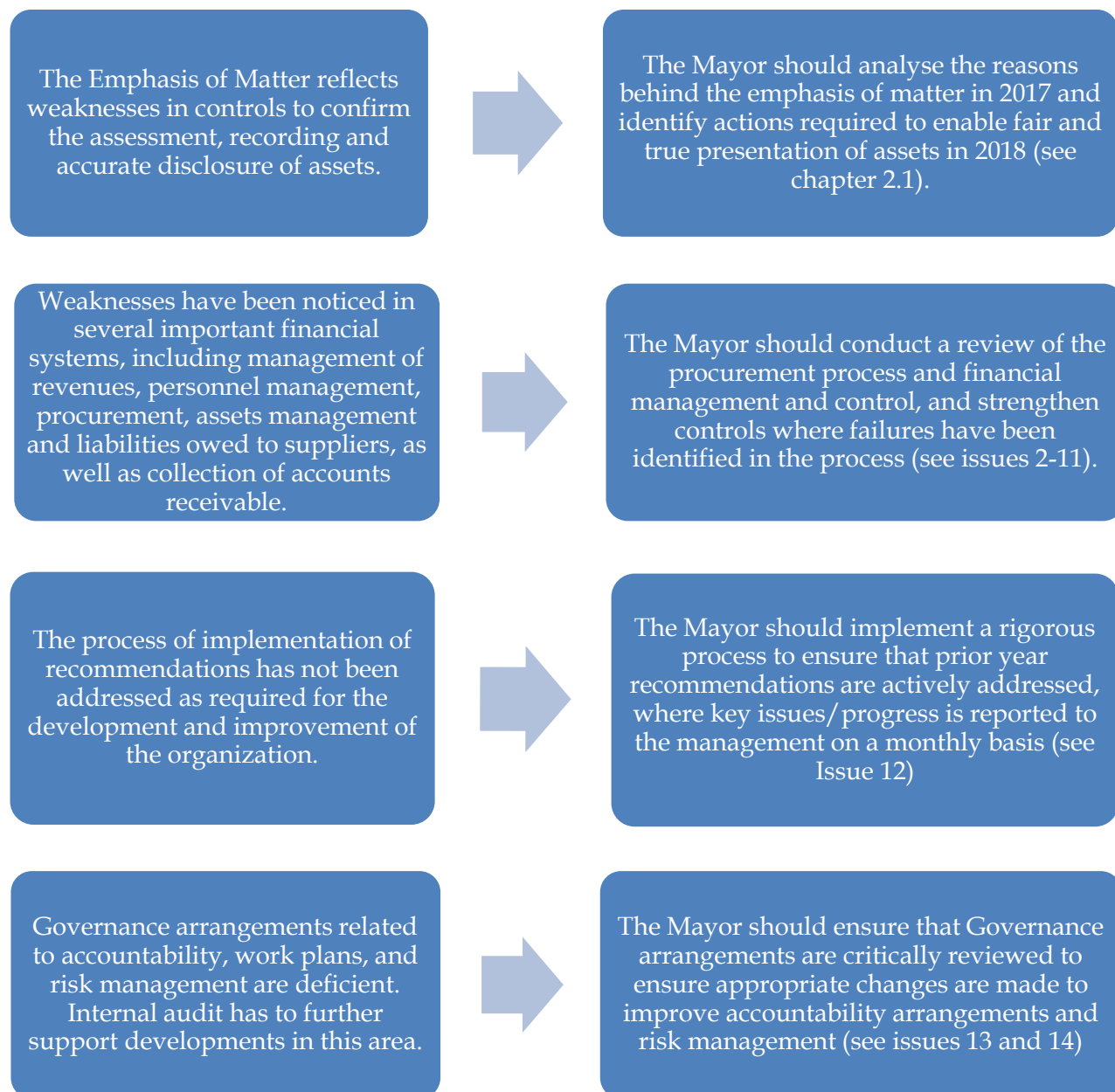
We draw your attention to the fact that municipal properties have not been recorded in the assets module in the KFMIS, while for non-capital assets there is no complete and accurate register.

For more, please refer to Section 1.2 of this report.

Annex I explains the different types of Opinions applied by the National Audit Office.

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## Key Conclusions and Recommendations



## Management response to audit 2017

The Mayor has considered and agreed on the audit findings and conclusions and has committed to address all given recommendations.

# 1 Audit Scope and Methodology

## Introduction

The National Audit Office (NAO) is responsible for carrying out a Regularity Audit which involves the examination and evaluation of Financial Statements and other financial records and expression of opinions on:

- Whether the financial statements give a true and fair view of the accounts and financial 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.

Audit work undertaken reflected our audit risk assessment for Municipality of Junik. We have analysed Municipality's business to 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 AG's opinion.

The following sections provide a more detailed summary of our audit finding with emphasis on observations and recommendations in each area of review. Management's response to our findings can be found in Annex III.

Our procedures included a review of the internal controls, accounting systems and related substantive tests and related governance arrangements 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 that 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 audit of the Annual Financial Statements (AFS) considers both compliance with the reporting framework and the quality and accuracy of information recorded in the AFS. We also consider the Declaration made by the Chief Administrative Officer and Chief Financial Officer when the draft AFS are submitted to the Ministry of Finance.

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 AFS. These assertions are intended to provide the Government with the assurance that all relevant information has been provided to ensure that an audit process can be undertaken.

### 2.1 Audit Opinion

#### **Unmodified Opinion with Emphasis of Matter**

We have audited the AFS of the Municipality of Junik for the year ended on 31st of December 2017, which comprise of the Statement of Cash Receipts and Payments, Budget Execution Statement and the Explanatory Notes of the Financial Statements.

In our opinion, the Annual Financial Statements for the year ended on 31<sup>st</sup> of December 2017 present a true and fair view in all material respects in accordance with International Public Sector Accounting Standards (cash based Accounting), Law no.03/L-048 on Public Finance Management and Accountability (as amended and supplemented) and Regulation no.01/2017 on Annual Financial Reporting of Budget Organisations issued by the Ministry of Finance.

#### **Basis for the opinion**

Our audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the AFS section of our report. We believe that the obtained audit evidence is sufficient and appropriate to provide a basis for the opinion.

**Emphasis of Matter**

We draw your attention to the fact that:

- 275 municipal properties were not recorded in the accounting register of KFMIS;
- Educational facility of Junik in the net value of €185,009, continues to remain erroneously recorded in the Treasury's accounting register within the Municipality of Decan; and
- The e-assets program is not used sufficiently, and as a result there is no complete and accurate register of non-capital assets and consumable material. This reflects inaccuracies in the assets registry and inaccurate disclosure in the AFS of 2017.

**Responsibility of Management and Persons Charged with Governance for AFS**

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

**Auditor General's Responsibility for the Audit of the AFS**

Our responsibility is to express an opinion on the AFS based on our audit. We conducted our audit in accordance with ISSAIs. These standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will detect any material misstatement that might exist. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could influence the decisions taken on the basis of these AFS.

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

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

## 2.2 Compliance with AFS and other reporting requirements

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

- Compliance with MoF Regulation no.01/2017 on the Annual Financial Reporting of Budget Organisations;
- Requirements of LPFMA no. 03/ L-048, (as amended and supplemented);
- Compliance with Financial Rule no.01/2013 and 02/2013;
- Action Plan on implementation of recommendations;
- Self-assessment questionnaire of components of the Financial Management and Control;
- Annual procurement plan and annual report on public signed contracts; and
- Quarterly reconciliations of expenses and revenues with the Treasury.

The AFS were prepared in accordance with reporting format, and were signed and submitted within the legal deadline in the MoF.

Municipality of Junik had adjusted the AFS by improving their reporting, but even after the adjustment, assets disclosure is not complete and accurate.

Given the above, the Declaration made by the Chief Administrative and Financial Officer upon submission of the AFS to the Ministry of Finance can be considered correct.

In the context of other external reporting requirements we have identified that Municipality has not submitted to the MoF detailed quarterly reports on the physical progress of implementation of capital projects.

## 2.3 Recommendations related to Annual Financial Statements

Related to abovementioned issues are given the following recommendations:

**Recommendation 1** The Mayor should ensure that an analysis is undertaken to determine the causes of the Emphasis of Matter, and take specific actions to address causes systematically and to confirm complete recording of capital assets.

In addition, the Mayor should ensure that effective processes are in place to confirm that the 2018 AFS production plan formally addresses all compliance issues related to the AFS and includes Management review of the draft AFS with specific focus on high risk areas and/or areas where errors have been identified in previous years. The Declaration made by the Chief Administrative Officer and Chief Financial Officer should not be signed unless all necessary checks have been applied to the draft AFS. Furthermore, the Mayor should ensure that have been met all other reporting requirements in line with applicable rules.

## 3 Financial Management and Control

### Introduction

Our work related to Financial Management and Control (FMC) reflects the detailed audit activities undertaken on Revenue and Expenditure Systems within Budget Organisations. Specifically, the focus of the audit was Budget management, Procurement issues, Human Resources as well as Assets and Liabilities.

### Financial Management and Control Conclusion

Although the Municipality of Junik has made a number of governance improvements, there are still a number of areas where further developments are needed. Some of the issues raised by last year's audit were not sufficiently reviewed. Assets recording and management has not been addressed adequately by the management.

In the context of financial systems, controls over revenues are generally appropriate and are being implemented effectively – but controls over a range of expenditure areas require further enhancement to prevent irregularity of expenditures and non-rational expenditures. The main areas where most improvements are required are in budget execution for capital investments, management of personnel, assets and account receivable.

#### 3.1 Budget Planning and Execution

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

**Table 1. Sources of budgetary Funds (in €)**

Description	Initial Budget	Final Budget <sup>1</sup>	2017 Outturn	2016 Outturn	2015 Outturn
<b>Sources of Funds</b>	1,533,899	1,814,384	1,754,304	1,584,964	1,785,539
Government Grant -Budget	1,391,912	1,542,163	1,534,867	1,179,419	1,241,339
Carried forward from previous year <sup>2</sup> –	-	17,699	17,697	13,442	20,850
Own Source Revenues <sup>3</sup>	141,987	141,987	89,483	69,306	64,122
Domestic Donations	-	20,917	20,900	4,082	-
External Donations	-	91,618	91,357	318,715	459,228

<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.

The final budget is higher than the initial budget by €280,484. This increase is a result of donations and revenues carried forward from the previous year, as well as changes applied after the budget review and in line with Government decisions.

In 2017, the Municipality of Junik has spent 97% of the final budget or €1,754.304, or 3% higher than in 2016. The budget execution was at a satisfactory level, and we have provided explanations below on the current position.

**Table 2. Spending of funds by economic categories - (in €)**

Description	Initial Budget	Final Budget	2017 Outturn	2016 Outturn	2015 Outturn
<b>Spending of funds by economic categories</b>	<b>1,533,899</b>	<b>1,814,384</b>	<b>1,754,304</b>	1,584,965	1,785,539
Wages and Salaries	1,000,466	1,056,758	1,054,758	1,005,752	1,091,463
Goods and Services	130,012	189,563	184,416	211,927	291,150
Utilities	30,000	30,000	29,476	29,904	29,232
Subsidies and Transfers	5,755	6,050	6,050	5,460	7,000
Capital Investments	367,666	532,013	479,604	331,922	366,694

Explanations for changes in budget categories are given below:

- Wages and Salaries – the final budget had increased by €56,292. The increase was affected by external donations in the amount of €36,042, and in agreement with the Government Decision for €20,251;
- Goods and Services – the final budget had increased by €59,551. Initially this was affected by the own source revenues carried forward in the amount of €3,676 and external donations in the amount of €25,875. With changes applied after the budget review and in agreement with Government decisions, this category has increased by €30,000;
- Utilities – There were no budgetary changes in this category;
- Subsidies and Transfers – the final budget had increased from revenues carried forward in the amount of €295; and
- Capital Investments – the final budget had increased by €164,346. This was affected by the own source revenues carried forward in the amount of €13,728 and external donations in the amount of €50,619. With changes applied after the budget review and in agreement with Government decisions, this category has increased by €100,000;

## Recommendations

We have no recommendations in this area.

## 3.2 Revenues

Revenues generated by the Municipality of Junik were €122,377, or 86% of the plan. Compared to the previous year, the level of revenues collected has increased by 46%. Largest part of revenues generated come from municipal tax on construction permits by €42,293 and revenues from property tax €39,677. Municipality also collects other types of revenues, such as revenues from business activities, inspections and other administrative fees.

**Table 3. Own Source Revenues (in €)**

Description	Initial Budget	Final Budget	2017 Receipts	2016 Receipts	2015 Receipts
Own source revenues	141,987	141,987	122,377 <sup>4</sup>	83,989	77,573

### Issue 2 – Deficiencies in collection and recording of revenues

**Finding** Revenue collection plan for licenses and permits to conduct business activity was collected at only 24%. Even revenues collected in this economic code of revenues are incorrectly recorded in the KFMIS as other administrative fees.

In addition, in two cases, revenues in the amount of €1,950 besides being recorded with two weeks delay in KFMIS, were not even classified in the respective economic codes.

**Risk** Setbacks in revenue collection have negative impact in terms of municipal budget and in implementation of the annual program. Late recording and misclassification of revenues make reconciliation of data and financial reporting difficult.

**Recommendation 2** The Mayor should ensure that collection performance is systematically monitored by the respective directorates and the finance office, and that this review addresses on time the barriers that hinder revenue collection according to the plan, and to ensure that revenues are classified correctly and recorded on time to the KFMIS.

## 3.3 Wages and Salaries

Wages and Salaries are paid through a centralised system managed by MPA and MoF. At the end of 2017, Municipality of Junik had 201 employees, including 39 members of the Municipal Assembly. For wages and salaries was spent almost the entire budget of this category or €1,054,758. The share of wages and salaries in the overall municipal expenditures is 60%.

<sup>4</sup> Në këtë vlerë nuk janë përfshirë edhe të hyrat indirekte nga jobat në trafik dhe dënimet gjyqësore në vlerë totale 5,633€.

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## Recommendations

We have no recommendations in this area.

## 3.4 Personnel Management

Our audit included personnel files, recruitment procedures, annual performance appraisals, retirements, as well as unpaid leave and maternity leave. Administrative staff members with the status of civil servant are managed by the personnel office in the Municipality, while the educational personnel and health personnel are managed by respective directorates, Directorate of Education and the Directorate for Health and Social Welfare.

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### Issue 3 – Irregularities in personnel management

#### Finding

The audit on personnel management has identified that:

- For the position of *Teacher/Primary Program*, the recruitment process was developed even though was not met the condition that for announced position should be at least three candidates. Moreover, although it was required under the competition, the candidate had not provides court's certification that proves that the applicant is not under investigation procedure or convicted for a criminal offense;
- For the position *family medicine nurse*, regular recruitment procedures were not developed. As a replacement of the vacancy, based on a decision was recruited an employee that was previously engaged under Special Services Agreements; and
- Contracts of healthcare personnel were drafted based on the law on civil servants. Employment issues and contracts for this category of employees are handled with the Labour Law. Following our recommendations, the management has taken the necessary actions and from the beginning of 2018 the contracts of healthcare personnel were drafted according to the Labour Law.

#### Risk

Avoiding and inadequate application of recruitment requirements and procedures, besides being in disagreement with legal rules and procedures, also pose a risk of engaging inadequate persons, and do not ensure that adequate personnel was recruited.

#### Recommendation 3

The Mayor should ensure that recruitment activities are conducted in accordance with relevant procedures and regulations that ensure equal treatment for all potential competitors.

### 3.5 Goods and Services and Utilities

The final budget for goods and services and utilities in 2017 was €219,563, out of which were spent €213,892 or 97% of the budget of these two categories. Mostly, they relate to costs of utilities and operational activities related to other contractual services, office supplies and equipment, fuel, maintenance, etc.

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#### Issue 4 - Deficiencies in management of special services agreements

**Finding** Nine employees were engaged through special service agreements. Simplified recruitment procedures upon their selection were not developed. Contracts of five employees had exceeded the legal deadline of six months. Employees were paid in gross salary, without withholding the income tax and pension contributions. Following our recommendations, at the end of the year, the finance office started to withhold income tax and pension contributions.

**Risk** Avoiding simplified recruitment procedures when concluding contracts for special service agreements poses a risk of engaging inadequate persons to perform required services. In addition, due to Municipality's negligence to withhold income tax poses a risk as Municipality may be subject to penalties by tax authorities.

**Recommendation 4** The Mayor should ensure that special service agreements are concluded after development of simplified recruitment procedures, and only when there are specific requirements, and should be developed within the timeframe established under the legal framework.

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## 3.6 Subsidies and transfers

Municipality of Junik has spent the entire final budget for subsidies and transfers in the amount of €6,050. Subsidies were given to individual beneficiaries and to non-public entities.

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### Issue 5 - Lack of regulation on subsidies

**Finding** Municipality of Junik does not have an approved regulation on allocation of subsidies. A draft regulation was in the process of drafting although the Municipality did not yet approve it.

**Risk** Due to lack of a regulation is created uncertainty about subsidized projects and whether the allocation of subsidies is in agreement with established plans and objectives.

**Recommendation 5** The Mayor should ensure that the Regulation on subsidies is finalized and approved within a short period of time after the receipt of this report.

## 3.7 Capital Investments

The final budget for capital investments was €532,012, out of which were spent €479,604 or 90%. They relate to financing of capital projects in road infrastructure, educational facilities and investment maintenance, project design, etc.

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### Issue 6 - Deficiencies in purchases through public procurement

**Finding** In the procurement activity *asphalting of local roads in Junik*, in the amount of €437,390, one of the criteria was sufficient capital for implementation of the contract. Bidders had to have at least €20,000 on the bank account or unconditional access to a loan. In the bank evidence provided by the winning EO, it was not shown whether there are funds available in the account and there was no guarantee for an unlimited access to the loan.

**Risk** Failure to comply with required criterion poses a risk, as the Contractor may not have sufficient financial capacity to implement the contract under the contractual terms.

**Recommendation 6** The Mayor should ensure that public contracts are signed only with EOs that fully meet the criteria required under the Tender Dossier.



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**Issue 7 – Inadequate segregation of duties and responsibilities**

**Finding** In the contract *asphalting of local roads in Junik*, as contract manager was appointed the Head of Bid Evaluation Committee for this project. Rules and operational guidelines for public procurement stipulate that members of the evaluation committee cannot be appointed as a project manager.

**Risk** Inadequate delegation of duties and responsibilities may have negative impact in the financial and operational management of the project.

**Recommendation 7** The Mayor should ensure that segregation of duties and responsibilities is done in accordance with requirements and regulations on financial management and internal control.

### 3.8 Common Issues for Goods and Services and Capital Investments

In the following are presented common issues in the area of procurement related to goods and services, as well as capital investments.

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**Issue 8 - Planning and purchasing through procurement procedures**

**Finding** The expected implementation of procurement guidelines was not done due to lack of effective managerial oversight. This has resulted in:

- Incorrect planning by requesting units for purchases planned to be carried out with public procurement procedures;
- For three contracts the performance security had not covered the 30-day period from its completion; and
- In 10 cases commitment of funds and the purchase order were done after the receipt of the invoice, or after the delivery of works/supplies;

**Risk** Weaknesses in planning and implementation of procurement activities can have a negative impact in terms of budget and in implementation of contracts.

**Recommendation 8** The Mayor should ensure that a review of audit findings is undertaken where processes have not been applied effectively and adequate oversight has not been applied. In this regard, detailed analysis of planning and implementation of contracts should be conducted.

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### 3.9 Capital and non-capital assets

According to the AFS, the net value of capital assets at the end of the year is €2,094,057, while non-capital assets were €102,607. Municipality of Junik has established a work committee and has inventoried assets at the end of 2017. Another committee for assets evaluation was also established. The Committee was still in the work process, although deficiencies have still been identified in assets accounting register, which we have addressed in the Chapter Audit Opinion – Emphasis of Matter. In addition, the following deficiencies have been encountered.

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#### Issue 9 - Lack of controls over the management of official vehicles

**Finding** There are weaknesses in management of official vehicles, as there is no complete and accurate evidence on the use of official vehicles. There is no information regarding the requirements and authorizations on the use of vehicles and kilometres passed.

**Risk** Due to lack of controls and management poses a risk as vehicles may be used for other unofficial purposes.

**Recommendation 9** The Mayor should ensure that official vehicles are used in accordance with legal rules and requirements. For each official vehicle used whereas full and accurate records of passed kilometres, and other necessary data should be kept.

### 3.10 Receivables

Accounts receivable (AR) relate to property tax and revenues from business taxes.

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#### Issue 10 - Poor management of accounts receivable

**Finding** Receivables were not properly managed, as the Management has not taken necessary actions for timely collection of receivables. As presented in the AFS, their total value is €191,942, out of which 74% are from property tax.

The balance of accounts receivable for business taxes at the end of 2017 was €50,079. Receivables had remained uncollected from 2009 onwards. In two cases tested, we found no payments to have been carried out during 2017 from business activity tax. Collection from this type of revenue was the lowest.

**Risk** Delays in collecting revenues reduce collection of funds for the budget of the Municipality and makes fulfilment of the annual program difficult.

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**Recommendation 10** The Mayor should ensure that are actively reviewed all possible options, including legal means, to ensure timely collection of Accounts Receivable.

### 3.11 Outstanding Liabilities

According to the AFS, outstanding liabilities towards suppliers by the end of 2017 were €51,580, out of which €27,582 belong to capital investments, to goods and services €12,488, and to utilities €11,513. These liabilities were carried forward to be paid in 2018. In addition to financial liabilities, Municipality of Junik also faces contingent liabilities, and their value is expected to be around €43,000.

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#### Issue 11 – Entering into liabilities without budgetary means

**Finding** Municipality has not properly managed liabilities towards suppliers. Outstanding liabilities date from 2014 and onwards. They were not paid due to entering into liabilities without securing sufficient budgetary means. In addition, there were also delays in meeting liabilities to suppliers.

**Risk** Entering into liabilities without securing funds beforehand and failure to pay liabilities on time may result in additional costs and damage to the budget due to lawsuits filed by suppliers.

**Recommendation 11** The Mayor should ensure additional controls over the management of liabilities owed to contractors. Entry into liabilities should be done only if sufficient financial means have been committed in advance. Liabilities should be paid within 30 days from the receipt of invoices.

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## 4 Progress in implementation of recommendations

Our Audit Report on the 2016 AFS of Municipality of Junik resulted in 14 recommendations. Municipality had prepared an Action Plan stating how all recommendations will be implemented.

At the end of our 2017 audit, four recommendations have been implemented, four were in the process, and six have not been addressed yet. In addition, from the year 2015, 16 recommendations were carried forward, out of which in 2017 six were implemented, four were under implementation, and five 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 12 - Low level of implementation of recommendations from previous years

**Finding** Municipality of Junik has implemented the requirements to draft an action plan within 30 days after the receipt of the audit report for 2016 of the NAO, but a confirmatory process did not support this where the implementation of recommendations is formally monitored. This reflects lack of focus by the management to ensure that recommendations are implemented timely, while obstacles to actions are expected to be identified and addressed. Such an approach is necessary to have a continuous improvement throughout the organization.

While some of the recommendations of 2016 and those of previous years have been implemented only partially, deficiencies in key systems continue not being handled properly. We have not noticed that management had applied responsibility measures for non-implementation of recommendations.

**Risk** Failure to implement recommendations poses a risk as required improvements in operational and other processes may not be implemented, thus resulting in continuous inefficiency and financial loss.

**Recommendation 12** The Mayor should ensure that implementation of the Action Plan is constantly monitored and reported on quarterly basis related to the progress achieved in this regard. Recommendations that are not implemented under deadlines should be revised by the Mayor within a short period of time, and that are taken proactive actions against the obstacles encountered during implementation.

## 5 Good Governance

### Introduction

Good Governance implies basic principles of accountability, effectiveness of controls, risk management, independence of internal audit, coordination of NAO with internal audit and good governance with public assets.

A key tool supporting effective governance is the implementation of audit recommendations as this demonstrates that Management are seeking to develop existing processes and controls. The level of compliance with FMC requirements by Budget Organizations is monitored by the self-assessment checklists completed by all BOs, which are submitted at the end of the year to the Ministry of Finance.

Specific areas of our governance-related reviews have been the accountability and risk management process, while the other components are handled within the chapters or subchapters above.

### Overall Governance Conclusion

There is a number of governance weaknesses within Municipality of Junik particularly related to risk management. An effective response to audit recommendations and the operation of a high quality internal audit unit are not in place. The Audit Committee has not been established, while recommendations of the internal audit have not been addressed at the right level.

All Budget Organisations are obligated to prepare and submit organisation level strategic plans and annual plans such as: Urban Plans, Spatial Plans, Emergency Operations Plans, Anti-Corruption Strategic Plans, Regional Development Strategy etc. Municipality of Junik has drafted the municipal development plan, urban regulatory plan, internal regulations, annual work plans according to directorates, and the annual work report.

#### 5.1 Internal Audit System

The Internal Audit Unit (IAU) operates with one auditor. An effective audit requires a comprehensive work programme that reflects financial and other risks to Auditee and provides sufficient assurance over the effectiveness of internal control. The impact of Internal Audit output should be judged by the importance that management places on addressing recommendations and the support and challenge provided by an effective Audit Committee.

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**Issue 13 – Inadequate implementation of recommendations and lack of Audit Committee**

**Finding** Management has not sufficiently addressed recommendations of the internal auditor. Out of 38 recommendations given in the internal audit reports, IAU has considered that only 15 of them were implemented, 13 in the implementation process and 10 were not implemented. While for an audit report was not prepared an action plan for addressing of recommendations. Municipality has no established the Audit Committee.

These results reflect a lack of Management’s awareness to recognise and maximise the benefit of Internal Audit or to seek assurance over the effective operation of internal controls.

**Risk** Identified deficiencies reduce the assurance provided to management related to the functioning of financial systems. This can result in other unidentified weaknesses, late response to potential challenges and continuous ineffective practices that may end up with low value for money and/or potential financial losses for the Municipality.

**Recommendation 13** The Mayor should ensure full implementation of internal audit recommendations. Action plans for implementation of recommendations are to be monitored continuously by the management. Furthermore, to consider the possibility of establishing the Audit Committee, or in cooperation with another Municipality to engage the Audit Committee.

## 5.2 Management Reporting, Accountability and Risk Management

In order to have a proper planning, supervise the activities on a regular basis and allow effective decision-making, the Management needs to have regular reports. Accountability as a process is the acceptance of responsibilities, holding persons into account for their actions and disclosing results in a transparent way. Whereas, risk management is a process related to identification, analysis, evaluation and actions/measures taken by the Management to control and respond to risks threatening the Organization. The management organizes meetings with head officials, and has established a formal internal reporting process by municipal directorates.

Although, a range of internal controls are applied by Management to ensure that systems and operate as intended, we have noticed that the measures applied in several cases were not as effective and therefore do not provide an effective and timely response to the identified operational problems.

**Issue 14 - Informal processes over risk management**

**Finding** The Municipality does not have written policies and procedures on risk management, in particular on the risk of fraud and irregularities. There is no risk register yet compiled according to FMC requirements, there is no risk management strategy, and is not produced a report on their management. This has happened due to lack of accountability to senior management regarding the risk management process, and lack of knowledge within the departments on their roles in providing support for this process.

**Risk** Due to lack of effective and comprehensive risk management will weaken the quality of services provided to citizens, particularly if internal and external issues that affect this are not timely addressed. This is because proactive actions needed to prevent or avoid the impact of such issues will not be undertaken in a planned and systematic manner.

**Recommendation 14** The Mayor should ensure that direct responsibility for risk management is delegated to respective administration sectors, and to ensure quarterly reporting on implementation of requirements in this area.

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

## Annex I: Explanation of the different types of opinion applied by NAO

(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.



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*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 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: Progress in implementation of Prior and Earlier Year Recommendations

Audit Component	Recommendation carried forward from 2015	Implemented during 2017	Under implementation during 2017	Not implemented
1.4 Compliance with AFS and other reporting requirements	The Mayor should ensure that an analysis has been made to determine the reasons for the qualified audit opinion and emphasis of matter paragraph. Action must be taken to address material weaknesses in a systematic and pragmatic order to mitigate those weaknesses as disclosed in the basis for qualified opinion paragraph.		The municipality has undertaken improvement measures. Assets inventory has been done and its evaluation has started.	
	The Mayor should take appropriate action to ensure full regulatory compliance of the process of preparation of annual financial statements (AFS). The Declaration made by the Mayor and Chief Financial Officer when the AFS are submitted to the Government should only be signed after a comprehensive management review has been undertaken on the content and accuracy of the AFS.		AFS are prepared correctly with the exception of disclosure of assets.	
	The Mayor of the Municipality must ensure that Municipality submits monthly reports related to outstanding liabilities as required by reporting regulation and submission of the annual financial statements in Serbian language.	Yes		

2.3 Prior Year Recommendations	The Mayor has to revise Action Plan to address the recommendations of 2014. This plan must specify a reasonable time frame of implementation, responsible staff and mode of application, being initially focused on areas of high importance i.e. where material weaknesses were identified. Progress against the plan must be monitored directly by the Mayor.		The management had drafted an action plan, but the level of implementation of recommendations is low.	
3.3 Budget Planning and Execution	The Mayor of the Municipality should systematically and frequently monitor the budget performance and identify and address constraints to planned levels of budget execution. The Mayor of the Municipality should ensure that the implementation plan for own source revenues constitutes a realistic plan and coincides with the capabilities of the Municipality to collect revenues. Furthermore it should be ensured that all actions have been taken for collection of this revenue.	Yes		
3.4 Procurement	The Mayor has to identify the root causes of the deficiencies and take appropriate action to ensure procurement requirements are fully implemented.		In the process of implementation. Even this year were identified deficiencies in the procurement area.	
3.5 Non Procurement Expenditure	The Mayor should ensure that the Municipality takes further steps to improve controls over expenses and payments and strictly comply with the laws and local regulatory requirements.	Yes		
3.5.3 Subsidies and Transfers	The Mayor should ensure that the Municipality takes further steps to improve controls over subsidies and transfers and strictly comply with the laws and local regulatory requirements	Yes		

3.7.1 Capital and Non Capital Assets	The Mayor should ensure the following timely and accurate recording of all assets in the relevant registers in accordance with the requirements of regulation 02/2013. It also should ensure that capital assets register contains complete information, including the date when the asset was put in use, so that the calculation of depreciation can be performed accurately. As well as determine the ownership status.			No measures taken
	The Mayor of the Municipality must ensure that the Municipality maintains accurate and complete information in relation to non-capital assets and ensure that they are presented in the financial statements.			No measures taken
3.7.3 Receivables	The Mayor should ensure that accounts receivable are disclosed in a sufficient and detailed manner and the sufficient documents and information is retained. Furthermore the Mayor of the Municipality must ensure that the Municipality takes further actions for the collection of revenues and that the necessary controls exist which ensure that old balances disclosed collected by the respective parties.		Receivables have been presented correctly, but collection is not at the expected level.	
3.7.4 Debts	The Mayor should ensure that the Municipality will take further steps and develop action plans to execute the payments within the required period.			No measures taken

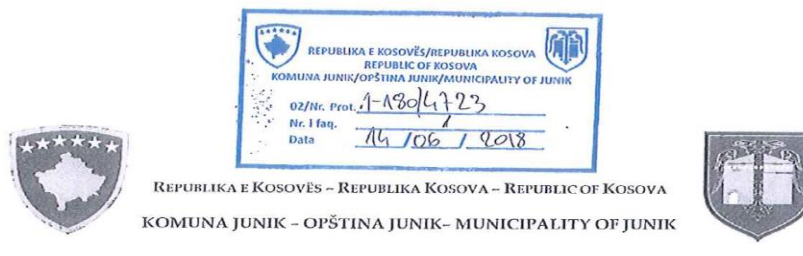
Audit Component	Recommendations given in 2016	Implemented	Under implementation	Not implemented
1.2 Compliance with AFS and other reporting requirements	The Mayor should ensure that an analysis is undertaken to determine the causes of the Emphasis of Matter. Actions should be taken to address the underlying causes in a systematic manner in order to record all capital assets. He should also ensure that the AFS preparation process fully addresses weaknesses identified in the AFS.			No measures taken
2.1 Progress in Implementing Prior Year Recommendations	The Mayor should ensure that a strengthened process of accountability is applied towards the staff in charge with the implementation of recommendations. Implementation progress should be monitored systematically and where setbacks are identified adequate measures should be taken.		The management had drafted an action plan, but the level of implementation of recommendations was low.	
2.2 Self-Assessment Checklist of FMC components	The Mayor should produce the risks register and ensure that its management is delegated to a responsible person who will systematically coordinate actions and measures set forth therein and will report to the Municipality's Management on regular basis.			No measures taken
2.4 Internal Audit System	In order to enhance oversight on the quality of internal audit services, the Mayor should ensure that the Audit Committee is established.			No measures taken

3.1 Budget Planning and Execution	The Mayor should ensure that, when applying coefficients, legal requirements are consistently implemented in order to avoid the possibility of unfair reduction or increase of the tax burden. In addition, the verification of 1/3 of properties subject to property tax should be made on annual basis and according to the quotes as stipulated in the law.	Yes		
3.1.2 Wages and Salaries	The Mayor should ensure that staff recruitment is conducted according to the applicable legislation.			No measures taken
3.1.3 Goods and Services and Utilities	The Mayor should ensure that the source withholding tax to persons engaged through special service contracts is applied in line with the applicable legislation.	Yes		
3.1.4 Subsidies and Transfers	The Mayor should produce an internal regulation on subsidies setting forth clear criteria and procedures on subsidies and have it approved by the Assembly. Given that many municipalities already have such regulations in place, we suggest to use them as a model and adapt them to the Municipality's needs.		Municipality has prepared a draft regulation on Subsidies but has not yet been finalized.	
3.1.5 Capital Investments	The Mayor should ensure that when making progress payments of future new projects or ongoing ones the construction books are applied and the same are reconciled with the stages in order to verify the accuracy of executed works and payments made. Project managers should be reminded that future activities should be carried out in compliance with the Law no.04/L-110 on Construction and AI no.15/2013 on Conditions of Keeping the Book and Construction Diary.	Yes		

	The Mayor should ensure that expenditures are classified under adequate economic categories as set forth in the accounting plan in order to reflect the fair presentation of expenditures in the AFS.	Yes		
3.2.1 Capital and Non-Capital Assets	The Mayor should ensure that all assets are recorded in the E-assets module, as required in Regulation 02/2013 on Assets Management.			No measures taken
	The Mayor should ensure that controls over the use of vehicles are put in place in order to provide for adequate accountability by each user of vehicles and to prevent irregular use of them.			No measures taken
3.2.2 Receivables	The Mayor should put in place more effective controls over these accounts by checking and placing the accurate amounts and should take actions to ensure as higher collection of these amounts as possible.		There is evidence on receivables, but collection is not at the expected level.	
3.3 Outstanding Liabilities	The Mayor should ensure that all received invoices are firstly archived in the book of incoming invoices and then paid according to deadlines set forth in the financial regulations.		Invoices are protooled, but there are delays in payments.	



## Annex III: Letter of confirmation



### LETËR E KONFIRMIMIT

Për pajtueshmërinë me të gjeturat e Auditorit të Përgjithshëm në Raportin e auditimit për vitin 2017 dhe për zbatimin e rekomandimeve

Për: Zyrën Kombëtare të Auditimit

Të nderuar,

Përmes kësaj shkrese, konfirmoj se:

- kam pranuar draft raportin e Zyrës Kombëtare të Auditimit për auditimin e Raportit/Pasqyrave Financiare të Komunës së Junikut, për vitin e përfunduar më 31 dhjetor 2017 (në tekstin e mëtejme "Raporti");
- pajtohem me të gjeturat dhe rekomandimet dhe nuk kam ndonjë koment për përmbajtjen e Raportit; si dhe
- brenda 30 ditëve nga pranimi i Raportit final, do t'ju dorëzoj një plan të veprimit për zbatimin e rekomandimeve, i cili do të përfshijë afatet kohore dhe stafin përgjegjës për zbatimin e tyre.

z. Agron Kuçi

Kryetar i Komunitës,

Data: 14 Qershor 2018, Junik,

