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Zyra Kombëtare e Auditimit
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National Audit Office

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AUDIT REPORT
ON THE ANNUAL FINANCIAL STATEMENTS OF THE
MUNICIPALITY OF RAHOVEC 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 Rahovec 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 Edon Kabashi (team leader) and Elvir Krasniqi (team member) under the management of the Head of Audit Department Luljeta Morina.

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Executive Summary

Introduction

This report summarises the key issues arising from our audit of the 2017 Annual Financial Statements of the Municipality of Rahovec 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 03/11/2017. 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. The National Audit Office acknowledges the Municipality's Senior Management and Staff for cooperation during the audit process.

Opinion of the Auditor General

Qualified Opinion with Emphasis of Matter

The Annual Financial Statements for 2017 *present a true and fair view* in all material aspects, apart from final budget, which was presented in value of €11,738,000, understating budget by €437,123 (the final budget according to the Treasury data was €12,175,539).

Emphasis of Matter

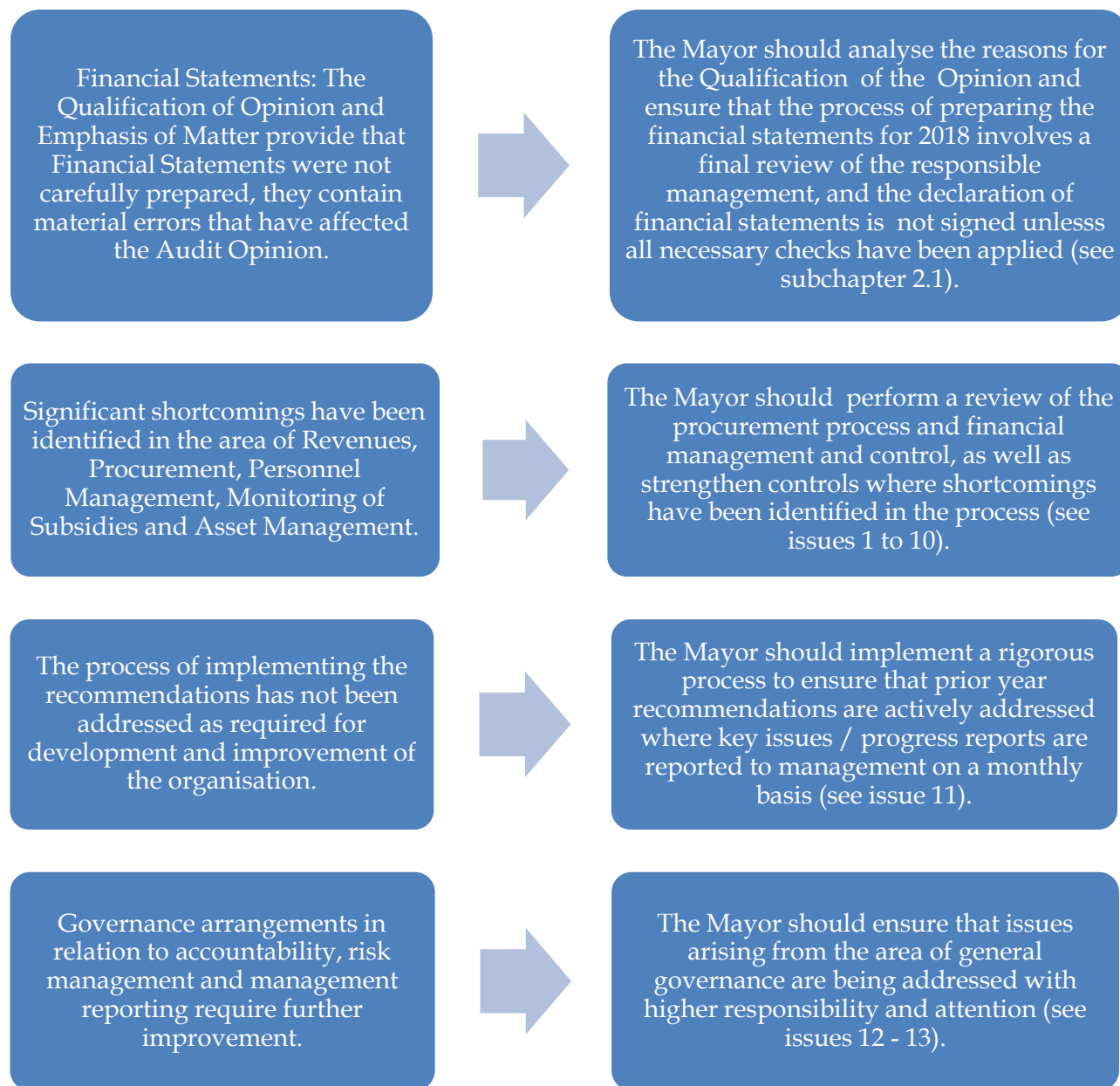
As Emphasis of Matter we would like to mention the fact that:

- Expenditures for Goods and Services in the amount of €77,221, as well as Subsidies and Transfers in the amount of €60,865 were budgeted, and executed wrongly by Capital Investments;
- The Assets disclosed in the annual financial statements were not accurate; and
- Contingent Liabilities in the financial statements were understated by €29,312,700.

For more, please refer to Section 2.1 of this report.

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

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 (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 Rahovec. We have analysed the 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 responses 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 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 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 (MoF).

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

1. Qualified Opinion with Emphasis of Matter

We have audited the AFS of the Municipality of Rahovec 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, except for the effects of the issue described in the Basis for Qualified Opinion paragraph, the Annual Financial Statements for the year ended on 31st 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 MoF no.01/2017 on Annual Financial Reporting by Budget Organisations.

Basis for Qualified Opinion

Article 14, Budget Execution Report, the final budget, was incorrectly presented in the amount of €11,738,000, understating the budget by €437,213 (final budget according to the Treasury data was €12,175,359). Errors were also reflected in the AFS disclosures. This occurred due to misplacement of the financial data on the amount of funds allocated by economic categories, instead of setting that of value of the final budget.

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. NAO is independent of the Municipality in accordance with the ethical requirements that are relevant to our audit of the annual financial statements of Budget Organisations in Kosovo and we have fulfilled other ethical

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

Emphasis of Matter

I would also like to draw your attention to the fact that:

- Expenditures for Goods and Services in the amount of 77,221¹, as well as Subsidies and Transfers in the amount of €60,865² were budgeted, executed and reported incorrectly by the category of Capital Investments. Misclassification have affected the two main statements as well as the disclosures of certain categories;
- The Municipality did not achieve to record assets that were purchased during the year (capital investments) in the amount of €526,279³ in the accounting register;
- Out of a total of 1140 owned lots, the Municipality has registered 1011⁴ of them, with a difference of 129 parcels, which have remained unregistered and evaluated;
- The Municipality have not included the school building "Selajdin Mullabazi" built by MEST in the property register; and
- According to the register provided by the municipal legal representative, Contingent Liabilities are in the amount of €32,499,129⁵, while the value of the Contingent Liabilities presented in the Financial Statements was €3,304,000, understated by €29,195,129.

Our Opinion have not been modified in relation to those issues.

Responsibility of the Management and Persons Charged with Governance for AFS

The Mayor of the Municipality of Rahovec is responsible for the 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

¹ "Summer and Winter Road Maintenance" - €19,745, "Demolition of illegally built buildings" - €9,013€, "Physical Security of Buildings and Cleaning Services" - 14,430€; "Maintenance of Roads and Waste Management" - €10,000; "Maintenance of Parks and Graveyards" - €9,356; "Purchase of Information Technology Equipment"- €4,693; and " Official Lunch "- €9,984.

² "Farmer's Plant houses " - €40,865€; "Project on increase of ambulatory healthcare and social services to the families"- €20,000.

³ Of total purchases from Capital Investments in 2017, the Municipality has registered only €2,464,704, with a difference of €1,071,782. As confirmed by the Municipality, unregistered capital investments are €526,279, and the rest part according to the municipality is not registered because they are goods and services, subsidies and transfers that are misclassified as capital investments.

⁴ This year only are registered 67 lots in value of €545,503.

⁵ Apart from this value, municipal legal representative report presented also some contingent liabilities in dinar currency, in value of 13,962,641 din.

number 03/L-048 on Public Finance Management and Accountability (as amended and supplemented).

The Mayor of the Municipality is responsible to ensure oversight of 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.

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

The Municipality 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; and
- Requirements of Financial Management and Control (FMC) procedures.
- Regular quarterly reports submitted in the Municipal Assembly; and
- Draft and Final; Procurement plan in time.

The AFSs submitted in January 2018 contained the following errors:

- Assets under €1,000 disclosed in the AFS were in the amount of €701,000, while according to a register kept in Excel format the Assets recorded value was €684,236, with a difference of €16,764. Furthermore, the Municipality has not applied depreciation of assets from the time of their purchase; and
- The Municipality has not recruited the Chief Financial Officer (CFO). The AFSs are signed by the Director of Finance, which is a breach of the LPFMA and the Treasury⁶ Rule 01/2017.

Above findings show that AFSs preparation was poorly managed.

Given the above - the Declaration made by the Chief Administrative Officer and Financial Officer when the draft AFS are submitted to the Ministry of Finance can be considered correct in all material respects, apart from issues described in the Basis of Qualified Opinion.

In the context of other AFSs and external reporting requirements, we have no issues to raise.

⁶ Statement should be signed by Chief Administrative Officer and Chief Financial Officer. Each Budget Organisation should have a Chief Financial Officer with a status of Civilian Servant.

2.3 Recommendations related to Annual Financial Statements

In relation to the above stated issues we give the following recommendations:

Recommendation 1 The Mayor should ensure that an analysis is undertaken to determine the causes of the Qualification and Emphasis of Matter. Actions should be taken to address the underlying causes in a systematic and pragmatic manner to remove errors in the classification of capital expenditure, registration of capital and non-capital assets, contingent liabilities, and to ensure that the Municipality has filled in the position of the Chief Financial Officer by an employee of Civilian Servant Status.

Further on, 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 Executive Officer and Financial Officer should not be signed unless all necessary checks have been applied to the draft AFS.

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

The municipality of Rahovec spent 96% of the final budget in 2017, which implies a good overall performance. Although the Municipality of Rahovec has made a number of improvements, there are still a number of areas which require further significant improvements. Issues raised by the previous year audit were not reviewed sufficiently by the management.

In the context of financial systems, revenue controls were not effective and were not properly implemented. Also, controls over a range of spending areas require further improvement to prevent improper execution of payments. Due to non-compliance with regulations, procurement is still an area of concern for the Municipality due to insufficient implementation of the regulations, which has resulted in poor value for money spent.

The main areas where most improvements are required are in monitoring of Subsidies and Management and Asset Management and Reporting, and Liabilities.

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 ⁷	2017 Outturn	2016 Outturn	2015 Outturn
Sources of Funds	11,908,739	12,175,359	11,661,181	11,567,016	11,473,317
Government Grant - Budget	10,661,007	10,616,798	10,591,533	10,420,032	10,403,275
Carried forward from previous year ⁸ -	-	210,194	205,751	245,380	256,666
Own Source Revenues ⁹	1,247,732	1,247,732	769,469	801,797	746,922
Domestic Donations	-	6,112	-	5,400	-
External Donations	-	89,195	89,100	94,407	66,454
Borrowings	-	5,328	5,328	-	-

The final budget in relation to the initial budget was increased by €266,620. This increase is a result of a government grant cut of €44,209, increase of revenues carried forward from the previous year €210,194, borrowings in the amount of €5,328, internal donations €6,112 and external donations €89,195.

In 2017, the Municipality have used around 96% of the final budget or €11,661,181, or the same as it has been executed in 2016 (96%).

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

Description	Initial Budget	Final Budget	2017 Outturn	2016 Outturn	2015 Outturn
Spending of funds by economic categories	11,908,739	12,175,359	11,661,181	11,567,016	11,473,317
Wages and Salaries	7,028,178	7,017,400	6,991,962	6,966,078	6,818,898
Goods and Services	706,110	712,987	694,080	657,625	771,189
Utilities	250,500	250,500	249,753	250,497	280,665
Subsidies and Transfers	191,322	191,322	188,900	173,992	142,160
Capital Investments	3,732,629	4,003,150	3,536,486	3,518,824	3,460,405

⁷ Final budget - the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

⁸ Own Source Revenues unspent in previous year carried forward into the current year.

⁹ Receipts used by the entity for financing its own budget.

Explanations for changes in budget categories are given below:

- The **decrease** in the final budget for Wages and Salaries of €10,778 is a result of the **increase** from the carried forward revenues to €8,431 and the decrease from government decision by €19,209;
- The final budget for Goods and Services is increased by €6,877 as a result of revenues carried forward by €375, revenues from external donations by €1,174 and financing from borrowings by €5,328; and
- The final budget for Capital Investments was increased by €270,521. Initially, it was raised to €295,520 (carried forward revenues in the amount of €201,389, and external donations €94,131), while at the end of the year it was reduced by a government decision of €24,999.

Recommendations

We have no recommendations in this area.

3.2 Revenues

Revenues generated by the Municipality in 2017 totalled €820,959. These relate to revenues from property tax, revenues from construction licenses, revenues from rent, administrative fees, etc. The audit has disclosed that there is a need for further improvement of some processes and controls related to revenue planning and collection, in order to increase their collection, as well as the accuracy and completeness of the reporting.

Table 3. Own Source Revenues (in €)

Description	Initial Budget	Final Budget ¹⁰	2017 Receipts	2016 Receipts ¹¹	2015 Receipts
Own source revenues	1,247,732	1,247,732	820,959	1,009,926	969,696

In addition to the presented regular revenues, the Municipality have also collected revenues from traffic fines and court punishments in the amount of €118,288¹² which were collected by central institutions.

¹⁰ In the planning of revenue with initial and final budget the municipality has also included the planning of indirect revenues

¹¹ Receipts for 2016 and 2015 also include indirect revenues.

¹² Fines/ penalties by the Kosovo Police € 77,458 and fines / penalties by the court € 40,831.

Issue 2 – Non-compliances in management of tax on property

Finding The Municipality have not managed to perform verification of 1/3 of the immovable property as required by the Law on Immoveable Property Tax no. 03 / L-204 and applicable AI. Out of a total of 13,075 properties so far, the municipality has verified only 444 or slightly over 3%.

According to the Law on Property Tax, Article 9 states Every natural person who, on or before 1 March of a tax period, establishes that the property or residential unit serves as his or her principal residence shall be allowed a deduction of ten thousand (10.000) Euro from the taxable value of the property. In two cases, the Municipality failed to comply with this legal requirement by applying a deduction of €10,000 for two or more properties registered as the principal residence for the same taxpayer. Such shortcomings are directly related to the municipality's inability to conduct property verification and to identify problems.

Risk Failure to update the data related to the verification of 1/3 of the property may result with lack of complete information on current taxable property, which may produce less incomes from this category for the Municipality.

Failure to apply charges according to the legal requirements on property tax increases the risk for lower collection of revenues from this category.

Recommendation 2 The Mayor should take all necessary actions to ensure that a 1/3 property verification is carried out, so that property tax records are complete and to get the optimum benefits of this property. Additional actions should be undertaken to ensure that the deduction of €10,000 is applied only to the principal residences.

Issue 3 – Delays in collection of rent

Finding In two cases the municipality in capacity of a lessor had not collected the rent in accordance with the contracted terms. Under the contract for use of immovable property (business premises), the monthly rent must be paid no later than the 5th day of the upcoming month by the tenant, but the municipality did not apply regular billing under the contract and in these Income cases are not collected on time and evidence on account receivables may not be full.

Risk Poor management of leased property contracts and unwillingness to take effective measures in collection of revenues, increase the risk for non-accomplishment of the revenue plan and reflect less capital projects that are planned to be financed by them.

Recommendation 3 The Mayor should ensure effective management of leasing contracts and establish effective mechanisms for collection of revenues in accordance with the contracted terms, respectively to follow deadlines for collection of leased assets.

3.3 Wages and Salaries

Wages and Salaries are paid through a centralised system. Controls operating at municipal local level relate to: checking payments, signing of payroll lists; verification of possible changes that may appear between the application formats; budget review for this category and reconciliation with the Treasury. Expenditures for salaries during 2017 are €6,991,962 or around 100% of the planned budget.

Recommendations

We have no recommendations in this area.

3.4 Personnel Management

The purpose of the Human Resources Management is coordinating the organization's activities to ensure the operation of the system in accordance with the municipal administration and municipal assembly policies, which are applied throughout the organization.

Issue 4 - Inadequate management of Personnel Files/ Records - Medium Priority

Finding The Municipality had not yet completed the personnel files in accordance with Regulation no. 03/2011 "On the Files and the Central Registry for Civil Servants".

- In four files of civil servants were missing documents such as: birth certificate, citizenship and attestation that employees were not under investigation, while in another case they lacked: identity cards, qualifications and training documents, application forms and evaluations and references from previous employers ; and
- In ten cases of Education and Health employees, the files were not complete: in both cases there was no birth certificate and citizenship; in some other cases there were no identity cards, application forms, performance evaluation, sick leave forms, and all lacked evaluation of the application form and attestations that employees are not under investigation. Also, the municipality did not have a policy (written regulation) in place in relation to the management and maintenance of files for these sectors. The education/teaching staff, are required performance evaluation according to the AI no. 14/2013.

Risk Failure to update files and non-completion with the required documentation increases the risk for inadequate staff management and reflects irregularities and lack of information on employed staff.

Recommendation 4 The Mayor should ensure that specific steps have been undertaken to improve controls on personnel files so that all records are complete with the necessary documentation for management of staff, and assessment of their performance (annual performance evaluation). The Municipality should issue an internal act (policy) on performance evaluation.

3.5 Goods and Services and Utilities

The final budget of Goods and Services and Utilities in 2017 was €963,487, out of which €694,080 was used on Goods and Services and €249,753 for municipal expenditures.

They mainly relate to utilities, trips, telecommunications, purchase of furniture and equipment, fuel, registration and insurance services, maintenance, etc.

Issue 5 – Signing of contract without procurement procedures

Finding In two cases, contracts "Internet Services" and "Interest on Waste Collection Services" were concluded without procurement procedures, contracting a monthly fee of €15 for each. The services were contracted according to the agreement that was signed directly by the Director of school with the economic operator.

Risk Failure to apply procurement process reduces the transparency on use of public money and the municipality may be provided services of unfavourable prices that reflect improper spending of the budget in this category.

Recommendation 5 The Mayor should ensure that the Law on Public Procurement is applied, in order for every service to be contracted based on competition.

3.6 Subsidies and Transfers

The final budget of Subsidies and Transfers was €191,322, out of which €188,900 or 99% were spent in 2017. Those mainly relate to subsidises for agriculture, support to cultural, sports activities, scholarships and one-time payment.

Issue 6 – Shortcomings in award of subsidies

Finding In the category of Subsidies and Transfers, we identified the following non-compliances:

- According to the decision of the Municipal Assembly and the agreement "On covering expenditures for funeral services" between the municipality and the Council of the Islamic Community branch in Rahovec, the municipality made two payments in total amount of €21,118 for services provided by the Islamic Community. These payments were not made to the account of the Islamic Community as defined by Article 6 of this agreement, but were made on private account of the natural person. The reason for execution of payment in this form was because the Council of the Islamic Community Rahovec branch does not have a bank account; and

- When covering expenses on funeral services for the citizens of the municipality, in many cases the civil status office did not make correction to the civil registry. The deceased persons were not removed from this register, whom for the Islamic Community has provided services and has supplied the municipality with the necessary death certificates, as required by Articles 47.7 and 47.8 of the Law on Civil Status.

Risk Execution of payments in private account increase the risk that the subsidy will not be used to its purpose and will allow mismanagement or misuse of funds by beneficiaries. Non-removal of deceased persons from the civil registry records provides inaccurate evidences for the municipality.

Recommendation 6 The Mayor should ensure that payments are made to the official account of the subsidy beneficiary, and adequate measures are taken to ensure that the civil registry is updated on a regular basis.

3.7 Capital Investments

The final budget of Capital Investments was €4,003,150, out of which €3,536,486 were spent in 2017. Those relate to expenditures for infrastructure, road and school construction, supply and different repairs of capital assets.

Issue 7 – Entering into contractual liabilities, without funds

Finding In 2017, the municipality entered into contractual obligations more than the funds allocated by the Law on Budget Appropriations, which is in contravention of Article 9.3 of the PPL. "Construction of cobbled roads in Dobidol, Palluzh, Ratkoc, Geje, Kramovik and Red Stone" and "Construction of the road in Drenoc, Qifllak, Denjë, Malësi e Vogël and Optrush", the amount of allocated budget for three years was only €213,001 while the value of the signed contracts was €545,868. The deficit of funds in relation to the related contracts was €332,867. This is due to inadequate municipal budget planning.

Risk The municipality's entry into contracts without commitment of sufficient funds, and not planned by mid-term budgetary framework, increases the risk for delays in execution of these projects or may risk their full execution.

Recommendation 7 The Mayor should provide additional checks on signed contracts, so that budget funds are committed prior to entering into contractual obligations. Long-term commitments should be harmonized with the dynamics of projects and planned with the Municipal Mid- Term Budget Framework.

3.8 Common Issues on Goods and Services and Capital Investments

The following common issues relate to Goods and Services and Capital Investments: According to the report of the procurement office, out of 75 planned contracts 57 or 76% of them were signed.

Issue 8 - Delays in execution of payments

Finding In 14 cases, payments for received invoices were not executed within 30 days. The delays were between two and seventeen months. According to Financial Rule 01/2013, on expenditure of public money, Article 44 states that “any valid invoice and payment claim for goods and services supplied and/or works executed for the budget organization shall be paid within thirty (30) calendar days upon receipt of invoice or request for payment from the relevant budget organization.

Risk Delays in payment of liabilities within the legal deadline may result with increase and accumulation of municipal liabilities, becoming subject of legal actions, or incurring additional expenditures for the municipality, as a penalty for interest, court expenditures, etc.

Recommendation 8 The Mayor should ensure that the appropriate financial discipline is established to ensure that received invoices are paid within the legal time limit for the purpose of managing and controlling contractual obligations.

3.9 Capital and Non-Capital Assets

The value of Capital Assets presented in the AFS 2017 was €62,305,000, while the value of Non-Capital assets was €701,000. Stocks at the end of the year were €13,040. We have reviewed whether the record keeping process is in compliance with the requirements of the MoF Regulation - no. 02/2013 on management of Non-Capital Assets in budget organizations, the inventory process and the physical presence of assets, and we have identified the following issues.

Municipality of Rahovec did not make significant improvements in relation to the municipal property registration even after the recommendation given out by the last year's report, and the advice given in the Mid-term Audit Memorandum.

Issue 9 – Poor Asset Management

- Finding** The register of assets under €1,000 (e-Asset) is not constantly updated by the asset manager. Municipal lands are also recorded in this register, and this is in non-compliance with article 24.2 of the regulation on management of non-financial assets 02/2013.
- Finding** Municipality assets are not fully supplied with bar codes as required by section 6.4 of the Non-Financial Asset Management Regulation 02/2013. The assets in the administration were provided with bar codes, but not in MFMC and schools.
- Risk** Incomplete recording of assets and not updating in adequate registers causes the risk of misuse, loss or alienation of assets, and does not allow full and accurate disclosure in the AFSs.
- Recommendation 9** The Mayor should ensure that the management of non-financial assets is made in full compliance with Regulation 02/2013 on management of non-financial assets. In this regard, should provide controls on registration of non-capital assets, and ensure the full operation of the e-Asset system for registration of assets under €1,000, and stocks.

3.10 Receivables

Accounts receivable at the end of the year were €2,151,000. The structure of accounts receivable consists mainly of: Property tax, business activity taxes and rents.

Recommendations

We have no recommendations in this area.

3.11 Outstanding Liabilities

The statement of liabilities not paid to suppliers at the end of 2017 was €2,243,767. These liabilities are carried forward to be paid in 2018.

Issue 10 – Shortcomings in managing and reporting of liabilities

Finding The Municipality had not managed to have a good management and reporting of its liabilities. We have presented the following shortcomings:

- Compared with previous year the liabilities have increased by €1,323,219 (from €920,000 in 2016 to €2,243,767). Enormous increase of liabilities in relation to the previous year was a result of poor controls, or entering into contractual obligations without sufficient funds;
- In four cases, received invoices are not recorded in the invoice archiving book as required by Article 24.1.3 of the Financial Rule 01-2013 MoF – on Expenditure of public money; and
- In one case, the unpaid invoice for construction of the atmospheric water canal for the month of October 2017, in the amount of €24,795, is not included in the register of liabilities, understating the presented liabilities by the same value. This action is in violation of Article 17.3 of the Ministry of Finance Regulation no. 01/2017 on annual financial report of BO.

Risk The reported amounts of unpaid liabilities are significant for the municipal budget, and as such, may cause budget difficulties. Higher liabilities may also follow with budget execution through court decisions and additional expenditures for enforcement procedures. Failure to protocol invoices upon their receipt increases the risk for double payment, loss of invoices, insufficient and incorrect reporting of liabilities, and it may subsequently result in delays for fulfilment of obligations.

Recommendation 10 The Mayor should strengthen controls over the management and reporting of Outstanding Liabilities. Further on, should ensure that all received invoices are recorded and signed in the protocol book. Further on, should establish an effective control system by which all unpaid invoices are accurately and thoroughly reported on a monthly basis to the MoF, and correctly disclosed in the AFSs, at the end of each year.

4 Progress in implementing recommendations

Our Audit Report on the 2016 AFS of the Municipality of Rahovec resulted in 13 recommendations. The Municipality prepared an Action Plan stating how all recommendations will be implemented. The 2016 AFS Audit report was also discussed in the Municipal Assembly.

However, besides this, the level of implementation of the recommendations was low. By the end of our 2017 audit, two recommendations have been implemented, the other two are in the process of implementation and nine recommendations have not yet been implemented.

Also, from the year 2015, 13 recommendations were carried forward (two unimplemented, two others were being implemented, and nine have not been addressed.). For a more thorough description of the recommendations and how they are addressed, see Annex II.

Issue 11 – Implementing Prior and Earlier Year Recommendations

Finding

Due to poor process management and lack of a formal monitoring of the way of implementing recommendations from the NAO, only a small number of last year's recommendations and those previously carried forward have been implemented. The Municipality does not apply any added measure or activity to implement the recommendations provided by the auditor.

Non-implementation of recommendations has resulted in continued weaknesses in management controls in key financial systems such as:

- Weakness in the management and reporting of revenues and expenditures;
- Improper management of municipal assets and liabilities; and
- Lack of the reporting process and managerial accountability;

Risk

Failure to fully implement the recommendations increases the risk of continued presence of the same shortcomings and may result in continued ineffectiveness of the controls, difficulties in managing challenges in meeting the objectives or even in financial loss.:

Recommendation 11 The Mayor should ensure that the implementation of the action plan is monitored on a continuous basis and reported on a regular monthly or quarterly basis with respect to the progress achieved in this regard. Recommendations that are not implemented within the foreseen deadlines should be reviewed and proactive actions taken against the barriers presented during the 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 Budget Organisations, which are submitted at the end of the year to the MoF.

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 the Municipality, particularly related to accountability, risk management and the quality of management reporting. Self-assessment questionnaire which is filled in by the Municipality reflects this situation only partially, will some positive comments on presence of current arrangements that are not based on documentation.

A key tool to support effective governance is the implementation of recommendations given by external auditors. The effective response to the implementation of the recommendations is not satisfactory. This section is dealt with in more detail in the chapter 'Progress in implementing the recommendations'.

The Municipality has the Integrated Plan (2016-2018) in place, the urban modality plan (2016-2020), the waste management plan (2016-2021), the municipal development plan (2011-2020) and the 1987 general urban plan. However, other strategic plans such as spatial plans, strategic anti-corruption plan, regional development strategy etc. were still missing.

Internal Audit did not provide a clear picture of the level of assurance of internal controls due to the non-functioning of the audit committee.

5.1 Internal Audit System

The Internal Audit Unit (IAU) operates with two members of staff - the Head of IAU and one auditor. During 2017 IAU had planned and implemented seven audit reports.

To carry out an effective audit requires a comprehensive work program that reflects financial and other risks of the audited entity and provides sufficient assurance on the effectiveness of internal control. The impact of Internal Audit products should be judged by the management importance given to the addressing of recommendations, and by the support provided by an effective Audit Committee.

Issue 12 - Poor functioning of IAU

Finding

A number of weaknesses exist related to current IAU operations such as:

- IAU had not prepared reports on the level of implementation of the recommendations;
- IAU audit activities mainly include the period of last year, 2016; and
- The Audit Committee (CA) was not operational during 2017.

These results reflect a lack of awareness by Management in recognising and maximising the benefit of Internal Audit or seeking assurances over the effective operation of internal controls.

Risk

Insufficient audit coverage of the current year and operational activities in the process results in non-identification of actual shortcomings, resulting in inefficiencies to give assurance to the Management in relation to the functioning of internal controls. At the same time, the non-operation of CA in this regard, reduces the effectiveness of internal controls and repetition of identified weaknesses.

Recommendation 12 The Mayor should ensure that the IAU scope covers to a possible extent the current period by assisting the on-going operational activities. Further on, to ensure a higher focus of management to make the AC operational, towards achievement of this goal.

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.ke

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 are weak and ineffective and therefore do not provide an effective and timely response to the identified operational problems.

Issue 13 – Weaknesses in Management Controls and Risk Management

Finding As a result of poor management controls, substantial amounts from the capital investment budget have not been spent. Delayed procurement procedures, poor needs assessment, insufficient oversight, and failure to pay obligations in time were not timely and properly handled by the Management. As a result, some of the projects have not even started, while some contracts are subject to judicial proceedings. The Management does not carry out regular analysis of budget performance, does not review the procurement plan and has no regular reports on operational activities.

The Municipality also has no written policies and procedures for managing risks in place, in particular the risk of fraud and irregularities. There is no risk register drafted according to FMC requirements, there is no risk management strategy, nor any report on their management has been prepared.

Risk Poor accountability requirements and poor quality financial reporting reduce the effectiveness of financial management. This results in weaknesses within the budget process and reduces Management’s ability to respond to financial challenges in time. It also reduces the effect of budget controls and increases the risk of improper spending. Consequently, this may also result in providing poor quality services.

Recommendation 13 The Mayor should ensure that a review has been carried through to determine the form of financial and operational reporting to senior management. Budgetary performance, including revenues and expenditures, and procurement plan should be subject to regular reporting and review by the Management. Further on, in order to reduce the impact of risks to acceptable levels, the Organization should draft a risk register with all appropriate measures/actions to put the exposed threats under control.

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.

Determining the type of modification to the auditor's opinion

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

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

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

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

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

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

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

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

158. An Emphasis of Matter paragraph should:

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

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

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

Annex II: Progress in implementing Prior and Earlier Year Recommendations

Audit Component	Recommendation carried forward from 2015	Implemented during 2017	Under implementation during 2017	Not implemented
1.5 Recommendations	The Mayor should ensure that effective processes are in place to confirm that the 2016 AFS production plan formally addresses all issues raised, including significant risks on misclassification of expenditures and disclosure of assets. This also should include the management review of the draft AFS with specific focus on high risk areas and areas where errors have been identified.			No measures taken.
2.3 Prior Year Recommendations	The Mayor should strengthen control measures and accountability against those persons charged to fully address the recommendations that the actions defined in the Action Plan are implemented, particularly in high risk identified areas and within the timetable set.		Under implementation since a considerable part of recommendations are still to be implemented.	
2.4 Self-Assessment Checklist	The Mayor should ensure that completion of the self-assessment checklist is critical and ensure that areas of weaknesses are proactively addressed. The possibility of updating the municipal development strategy should be reviewed which would include clear objectives and achieve municipal objectives. Further on, a revised mechanism should be applied to provide evidence supporting self-assessment allegations.		It is in the process of finalizing the strategic plan, but the list of risks has not yet been drafted.	

2.5.1 Risk Assessment	The Mayor should ensure that a list is prepared where risks are identified according to the level and the likelihood that they may occur, and whether response measures are foreseen if they occur. Further on, the responsibility for risk management should be delegated to a responsible person who will report to management and ensure the implementation of the requirements in this field.			No measures taken.
2.5.2 Management Reporting	The Mayor should ensure that a review is implemented to determine the format of financial reporting to senior management which is required to support effective business management and ensure that an appropriate solution is in place.			No measures taken.
2.6 Internal Audit System	The Mayor should draft an action plan, which should be implemented by confirming responsible officials including timeframe to undertake the actions. Internal audit should have a special focus on activities in the current year, having preventive effect in terms of the actions. In order to strengthen the role of Internal Audit, the Audit Committee should be operational.			No measures taken.
3.3 Budget Planning and Execution	Approach to budget planning for capital projects needs substantial improvements. Before defining investment funds, the Municipality should carefully and objectively analyse which projects are of priority and which of them have a real chance to succeed. Timely procedures (project design, security performance, procurement, etc.) are some of the prerequisites for projects to be implemented according to plan.	Yes		

3.4 Procurement	The Mayor should conduct an internal review to determine why procurement requirements were not addressed in all procurement cases and exercise more controls to ensure that the systematic weaknesses identified are addressed. He should ensure that the Municipality will not enter into obligations more than the appropriations foreseen by law on budget appropriations.		Despite the improvements, the planning, entry into obligations according to budget allocations and the draft of a comprehensive procurement plan are still to be prepared.	
3.4 Procurement	The Mayor should examine the case why the Project Manager did not apply the terms of the contract and ensure that bill of quantity, calculations and other technical analyses for projects to be tendered are thoroughly carried out and deviations from the original contract are within allowed limits. After reviewing the case, the responsible persons should initiate appropriate accountability measures.			No measures taken.
3.5.1 Expenditure not related to Procurement	The Mayor should ensure that payments are not made before confirming that the works or services are rendered. Payments must be documented with reports confirming the receipt of the works/services. In terms of monitoring and reporting obligations arising from such agreements, it should be subject to regular reviews by the management of the Municipality. In order to eliminate the risk of failure for these agreements, we would suggest that such practices of payments are stopped.			No measures taken.
3.5.1 Expenditure not related to Procurement	The Mayor should review contracts for special services and ensure that such contracts are used only for the real needs and not engage persons for common positions.			No measures taken.
3.5.2 Remunerations (Wages and Salaries)	The Mayor should ensure that of night shifts at FMC are reviewed in order not to exceed the number of overtime and labour law is considered.	Yes		

3.6 Revenues	The Mayor should ensure that contracts are terminated as foreseen by the decision of MA for lessees who do not fulfil their obligations to the Municipality. In the future, the Municipality's property should be verified as required by law.			No measures taken.
3.7.1 Capital and Non Capital Assets	The Mayor should immediately establish the competent committees for proper and complete evaluation of all non-financial assets and monitor the results of the evaluation. Recording results should be integrated into a single register for all sectors. The process of recording assets higher than €1,000 in KFMIS should be continued until the recording is finalised. Asset Management Officer and officials involved in receiving municipal assets should communicate effectively to avoid non-implementation of the Regulation and non-consolidation of assets" value.			No measures taken.
3.7.2 Handling of Receivables	The Mayor should systematically monitor the issue of revenue collection, to ensure that appropriate policies and measures are taken to maximize the collection of debts. It is necessary to carry out a detailed analysis setting out the reasons of delays in payments and propose concrete actions and resources needed to collect these debts.			No measures taken.

Audit Component	Recommendations given in 2016	Implemented during 2017	Under implementation during 2017	Not implemented
1.3 Financial Statements	The Mayor should ensure that effective processes are in place to confirm that the 2017 AFS production plan addresses all issues raised in the report. This also includes Management review of the draft AFS with specific focus on areas where errors have been identified.			No measures taken.
2.1 Prior Year Recommendations	The Mayor should ensure that the monitoring group undertakes specific actions towards drafting a clear action plan on implementation of recommendations. This plan should be monitored at least quarterly, and is applied a rigorous accountability process in case this plan is not implemented.			No measures taken.
2.2 Self-Assessment Checklist of FMC components	The Mayor should ensure that a list of risks and strategic plan are drafted. The strategy should be monitored on constant basis to ensure that strategic objectives are being met. The Internal Audit Unit should conduct the final review in order to confirm the accuracy of the checklist, prior being submitted to the MoF.			No measures taken.
2.3.1 Setting of Strategic Objectives	The Mayor should draft strategic plans and set clear objectives in all sectors of the Municipality, and the same are systematically monitored in order to evaluate the initial planning and progress in achieving objectives in certain periods.			No measures taken.
2.3.2 Management Reporting and Accountability	The Mayor should ensure that a review is carried out to determine the form of financial and operational reporting and monthly written reporting is made by the Directors to the Management. In addition, to take measures to ensure that reporting by the CFO are done in line with legal requirements on the physical progress of capital investments.		Despite the improvements, the monthly form of written financial and operational reporting to management is still a challenge.	

2.4 Internal Audit System	The Mayor should ensure that the internal audit will focus on the activities in the current year and its contribution to be more productive through qualitative reports. In addition, to ensure that the Audit Committee is functionalised within a reasonable period.		The annual plan has been met, but the focus on current year activities is still a challenge, and the Audit Committee was not yet operational.	
3.1.1 Revenues	The Mayor should ensure when planning the revenues from property tax, the trend of collection as in prior periods is taken into account and ensure that the verification of municipal property is done on a regular annual basis, as required by law. In addition, should carefully administer all municipal properties and cease the use of public properties when users fail to meet financial obligations.			No measures taken.
3.1.5 Capital Investments	The Mayor should analyse the reasons why in the abovementioned cases procurement requirements were not implemented consistently, and to ensure that in the future contracts are awarded to the EOs that have the most favourable prices, and that EOs eliminated from tender are notified in writing.	Yes		
	The Mayor should implement requirements of the law and financial regulations and not to enter into contracts with EOs before allocating appropriate funds, and to ensure that will not be entered into contractual obligations beyond budget appropriations foreseen under the law on the annual budget.			No measures taken.
	The Mayor should ensure that the Procurement Office fully adheres to the requirements of the Tender Dossier, so that the contracts are concluded with responsive EOs, and procedures are fully transparent.	Yes		

3.2.1 Assets	The Mayor should ensure functionality of the e-assets system and strengthening of requirements so that all assets and stocks under €1,000 are recorded in this system.			No measures taken.
3.2.2 Receivables	The Mayor should ensure that a reassessment process is initiated, where all accounts receivable are analysed in terms of age and real possibilities for collection and propose concrete measures, not excluding administrative and other measures (if needed).			No measures taken.
3.3 Outstanding Liabilities	The Mayor should carefully analyse the reasons why the Municipality is uncontrollably creating liabilities, financing of which is not safe at all. Thereafter, should strengthen controls over liabilities and ensure that it will not enter into contracts without having a secure source of funds.			No measures taken.

Annex III: Letter of confirmation



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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 Rahovecit, për vitin e përfunduar më 31 dhjetor 2017 (në tekstin e mëtejshëm "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 implementimin e tyre.

z. *Smajlë Latifi*
Kryetar i Komunës,

Data: *2.1* Qershor.2018, Rahovec,

