REPUBLIC OF KOSOVA

OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT

ON THE FINANCIAL STATEMENTS OF THE MINISTRY OF LOCAL GOVERNMENT ADMINISTRATION FOR THE YEAR ENDED 31 DECEMBER 2014

Prishtina, June 2015

The Office of the Auditor General undertakes both Regularity and Performance Audits. The Acting Auditor General is the head of the Office of the Auditor General which employs around 145 staff. The Auditor General and the Office of the Auditor General shall be independent and certifies around 90 Annual Financial Statements each year, while undertaking other forms of audits.

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

The reports produced by the Office of the Auditor General directly promote accountability as they provide a base for holding managers' of individual budget organisations to account.

The Acting Auditor General has decided on the audit opinion and report on the Annual Financial Statements of the Ministry of Local Government Administration in consultation with the Assistant Auditor General, Ibrahim Gjylderen, who supervised the audit.

The opinion and report issued are a result of the audit carried out under the management of the Audit Director, Vlora Mehmeti, supported by Arian Haxha (Team Leader), Adelina Selmani and Laureta Matoshi (Team members).

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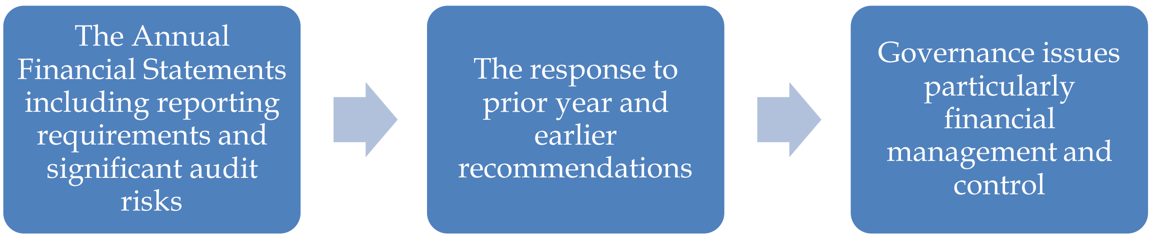
Executive Summary

Introduction

This report summarises the key findings from our audit of the 2014 Annual Financial Statements of the Ministry of Local Government Administration, which determine the Opinion given by the Auditor General. I would like to thank the Minister and his team for their assistance during the audit process.

The examination of the 2014 financial statements was undertaken in accordance with the internationally recognised Public Sector auditing standards (ISSAIs) issued by INTOSAI. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated 19.09.2014.

Our audit focus has been on:



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

Opinion

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

The Auditor General's opinion is:

In our opinion the Annual Financial Statements *present a true and fair view* in all material aspects (**ISSAI 200/1700 Unmodified Opinion)**.

Overall Conclusion

Our key conclusions and recommendations are:

The AFS have met all presentation requirements but included a number of errors and mistakes which are adjusted following the review of OAG	The Minister should ensure that the 2015 AFS production process incorporates formal, and effective management review.	See issue 1 at page 10
Budget execution during 2014 was not at the expected level. Budget for Capital Investments was used by 75%.	The Minister should implement a detailed assessment of the low budget execution level in Capital Investments and undertake measures to eliminate shortcomings.	See issue 4 at page 16
The public vacancy announcement criteria during staff recruitment and the staff promotion procedures were not adhered to in all cases.	The Minister should ensure that public vacancy announcement criteria are adhered to during staff recruitment, and that promotion is done though promotion procedures.	See issue 8at page 19
Irregularities were found in Assets management . The asset register is overestated, whilst officers who left did not return the assets they were using.	The Minister should ensure that asset are managed according to legal requirements and that asssets owned by MLGA are returned by officers that no longer work there.	See issue 10 at page 22

Management response – audit 2014

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

1 Audit Scope and Methodology

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

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

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

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

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

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

Our findings are defined as:

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

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

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

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

2 Annual Financial Statements and other External Reporting Obligations

Introduction

Our review of the AFS considers both compliance with the reporting framework and the quality and accuracy of the information recorded in the financial statements. We also consider the Declaration made by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) when the draft AFS are submitted to the Government.

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

Overall Conclusion

The draft AFS received from MLGA contained material errors which were adjusted following our advices. Adjusted AFS met all IPSAS requirements for 'Financial Reporting under the Cash Basis for Accounting' and Financial Rule No. 03/2013. The provided accurate and complete information relating to transactions presented in Public Sector "Financial Reporting under the Cash Basis for Accounting" and Financial Rule No. 06.2011.

In addition, all other external reporting obligations were fully met.

2.1 Audit Opinion

In our opinion the Annual Financial Statements *present a true and fair view* in all material aspects (**ISSAI 200/1700 Unmodified Opinion)**.

2.2 Compliance with AFS and other reporting requirements

Description

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

- Compliance with Financial Rule no. 03/2013;
- Requirements of LPFMA no. 03/ L-048;
- Budget requests;
- Quarterly reports including nine month financial report;
- Progress reports on capital projects in the amount over €10,000;
- Reports on outstanding liabilities;
- Draft plan and final procurement plan; and
- Action Plan for implementation of audit recommendations.

A number of financial adjustments were required to the draft AFS and we present them below. MLGA made the necessary adjustments in AFS, therefore - the Declaration made by the CEO and CFO when the draft AFS are submitted to the Government can be considered to be true and fair.

Issue 1 – AFS Production – High Priority

Finding	Ineffective processes applied during managerial review of AFS have resulted in the presentations of errors as follows: In the Budget Execution Statement – under the cash inflow – the final budget of €34,482 from donations was incorrectly presented. In addition, the execution from 2013 donations was presented in the amount of €42,206, whilst according to KFMIS records, the execution was €139,215. Further, the execution from 2012 donations presented was €40,154, whilst according to KFMIS was €30,218. As a result, the explanatory notes were incorrect.
Risk	Incorrect presentation of AFS leads to a misunderstanding of the institution's financial position. The material errors impact lead to AFS being subject to modification of opinion or Emphasis of Matter.
Recommendation 1	The Minister should ensure that an effective process is applied during the preparation of 2015 AFS in order to address the weaknesses identified in 2014 AFS. The AFS should not be signed unless a comprehensive review has been made by the Management to ensure the contents and accuracy of AFS before submission to the Government.

3 Prior Year Recommendations

Overall Conclusion

Having received our recommendations in the 2013 audit report, MLGA drafted an action plan for addressing recommendations. However, it was unable to fully implement them. As a result, similar shortcomings are found in some specific areas. It is important to undertake additional actions for the full implementation of recommendation in order to prevent same shortcomings from being repeated.

Description

Our Audit Report on the 2013 AFS of MLGA resulted in 11 key recommendations. At the end of our 2014 audit, four (4) recommendations have been fully addressed and five (5) were partially addressed and two (2) are not addressed at all. For a more thorough description of the recommendations and how they are addressed, see Annex II.

Issue 2 - Addressing Prior Year Audit Recommendations – High Priority

Finding MLGA was unable to undertake all actions required to fully implement AG's recommendations. As a result, similar weaknesses are repeated in the area of capitals budget planning and execution, management of expenditures, assets and debts.

Risk The continued weakness of management control and other controls over key financial systems have resulted in:

- Shortcomings in budget planning and executions for capitals;
- Lack of proper analyses related to MLGA's real needs for supplies; and
- Increase in liabilities due to the failure to commit funds in time.

Recommendation 2 The Minister should ensure that AG's recommendations are handled with due care by all levels of responsibilities in order to fully and timely address them.

4 Governance

Overall Conclusion

The key aspects of the Governance framework have been addressed by MLGA as follows:

- Self-assessment – is implemented but the quality and objectivity of the process were insufficient. An objective self-assessment process serves as the starting point to develop effective systems of FMC and to improve overall organisational performance.
- Internal reporting to the Management was adequate, except for assets reporting. Despite the regular reporting, management controls were inadequate.
- Internal Audit was not effective in the discharge of the annual audit plan. At the same time, management did not prepare the action plan for addressing the IA recommendations.

While controls over revenue are strong and are being implemented effectively – controls over a range of expenditure areas require further enhancement to prevent MLGA from suffering financial loss, poor value for money and ineffective asset management. The main areas where most improvements are required are Goods and Services, Subsidies and Assets.

4.1 Good Governance

Description

A range of internal controls have been applied by the Management to ensure that financial systems operate as intended. But, they were considerably not implemented in all key areas. It is important that reporting from subordinate units is critically reviewed in order to enable effective and timely response to the identified operational problems.

Issue 3 – Overall governance arrangements – High Priority

Finding

Some aspects of good governance have not operated in MLGA as intended.

- Our review on management controls applied in the key financial system of MLGA identified weak reporting on asset management to Senior Management. This resulted in poor asset management;
- Despite the regular formal reporting by subordinate units on the area of subsidies, personnel and goods and services, they are not used effectively by management to prevent systematic errors in these areas;
- The self-assessment requirement was just formally addressed because MLGA has not been able to fully identify the importance to support effective management. Self-assessment check lists have not foreseen the key measures or recommendations for improvements of areas with shortcomings and assertions in self-assessment were not supported with relevant evidence; and
- MLGA has not created formal and documented procedures for risk identification and management (risk register) at organisation level, which would mitigate the exposure to risks that relate to the achievement of objectives.

Risk

Weak reporting on asset to Senior Management has reduced the Management's effectiveness to actively manage MLGA assets. Management's failure to apply controls effectively has resulted in weaknesses in the process of expenditures and increases the risk for irregular expenditures.

Recommendation 3

The Minister should initiate review of the reasons behind the failure to apply controls over assets, subsidies and management of human resources effectively and address emphasised weaknesses in their management.

In addition, the Minister should ensure that self-assessment check lists and risk registers are used by Management as means that test the effectiveness of Financial Management and Control system in supporting their business objectives.

4.2 Budget Planning and Execution

Description

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

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

Description	Initial Budget	Final Budget[1]	2014 Outturn	2013 Outturn	2012 Outturn
Sources of Funds	**5,050,000**	**5,178,441**	**4,259,816**	**4,919,403**	**5,792,704**
Government Grant -Budget	5,050,000	5,037,474	4,148,756	4,877,197	5,752,550
External Donations	-	140,967	111,060	42,206	40,154

The final budget is higher than the initial budget by €128,441. This increase is a result of External Donations totalling to €140,967 and decrease of Government Grant by €12,526.

MLGA used 82% of the final budget in 2014, an improvement over 2% compared to 2013. However, the budget execution remains at an unsatisfactory level and explanations for the current position are detailed below.

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
Spending of funds broken down by economic categories	**5,050,000**	**5,178,441**	**4,259,816**	**4,919,403**	**5,792,704**
Wages and Salaries	756,746	812,621	809,979	666,931	696,535
Goods and Services	356,005	483,071	446,250	390,365	649,265
Utilities	30,000	25,500	18,878	25,724	23,401
Subsidies and Transfers	437,249	378,249	372,007	468,125	390,063
Capital Investments	3,500,000	3,479,000	2,612,702	3,368,258	4,033,440

[1] Final budget – the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

Explanations for changes in budget categories are given below:

- The final budget for Wages and Salaries compared to the initial budget increased by €55,875. Out of which, €34,874 were allocated for financing the Government decision to increase salaries by 25%, whilst the other part of €21,000 was for the staff involved in the "Brain Gain Fund ".
- The final budget for Goods and Services decreased by €49,000 compared to the initial budget (Government decision for budget savings by 15%). Later it was increased by €206,000. Out of which, €44,000 was transferred from Subsidies and Transfers and €33,000 from Capital Investments, whilst. The other €129,000 was European Commission grant for cross border cooperation. The budget for this category was executed by €446,250 or 92%.
- The final budget for Utilities was reduced by €4,000 compared to initial budget (Government decision for budget savings by 15%). The budget for this category was executed by €18,878 or 75%.
- The final budget for Subsidies and Transfers compared to the initial budget initially increased by €15,000 (on Government decision), then was decreased by €74,000 (€44,000 was transferred to Goods and Services and €30,000 to the Ministry of Labour and Social Welfare). The final budget for this category was executed by €372,007 or 91%.
- The final budget for Capital Investments compared to initial budget was decreased by 13%. Irrespective of the decrease, the final budget for this category was spent by 75%.

Issue 4 – Budget Execution – High Priority

Finding	The budget for Capital Investments was used only 75% and 56% of budget was spent in the last two months of the year. This occurred due to delays in the approval of projects by the Minister and due to delays in the execution of procurement procedures by Municipalities.
Risk	The low budget execution level in Capital Investments will result in failure to meet organisational objectives such as efficiency of local government and local administration reforms. As a result, this will burden the 2015 budget to pay last year liabilities.
Recommendation 4	The Minister should ensure a systematic assessment of the reasons behind the low budget execution level related to Capital Investments. The capital projects approval process should be in focus to find and avoid obstacles at an early stage. In addition, enhance of cooperation with municipalities should be facilitated in order to increase efficiency in discharging obligations in time by both parties.

4.3 Expenditures

4.3.1 Procurement

Description

During 2014, MLGA spent €2,820,924 through procurement procedures. We tested 33 payments of €94,592 from the category of Goods and Services and 60 payments in the amount of €2,083,216 from the category of Capital Investments. In addition, we tested eight procurement procedures in order to assess whether public procurement procedures have been developed in accordance with provisions of Law on Public Procurement. According to agreements between MLGA and municipalities, procurement procedures for Capital Investments financed for municipalities were conducted by the municipalities.

Issue 5 –Weaknesses in Procurement – High Priority

Finding	**Shortlisting of Economic Operators (EO) in lack of relevant business.** In two procurement[2] activities, the shortlisted EOs did not have their business registered for the activity they applied in the tender for. **Supply with commercials and announcements services without conducting procurement procedures.** Expenditures for commercials and announcements during 2014 were of €3,580. These services were carried out based on a Memorandum of Understanding entered into at the beginning of the year between the MLGA Secretary and seven domestic newspapers. According to this Memorandum, announcements were done on rotation in each newspaper, one time each, despite the fact that prices for same formats were different between these newspapers. Noncompliance with procurement procedures has resulted in services delivered with higher prices. **Supply with official travel tickets without conducting procurement procedures.** Expenditures for official travels abroad – travel tickets - during 2014 were of €22,400. In some cases these expenditures incurred by applying the minimal purchase method and in some other cases by using the contracts from Tax Administration of Kosovo and the Office of the Prime Minister. According to the procurement officer, failure to conduct open procedures for the delivery of these services was because they were not planned.

[2] a) Procurement activity for "Supply with furniture" in the amount of €4,997, price quotation procedure, only two out of three economic operators had their business registered for the relevant activity, such as the production of wooden products and mediation in the furniture merchandise.
b) In addition, procurement activity for "Supply with IT equipment" in the amount of €5,820, price quotation procedure, only one of the three bidders had their business registered for the relevant activity.

Risk A failure to develop procurement procedures as is foreseen under LPP for the provision of travel tickets and services limits the competition and reduces the level of transparency resulting in higher prices for services received. Further, shortlisting of EO with irrelevant business activity may result in supplies not delivered at the required quality.

Recommendation 5 The Minister should ensure that the Secretary General undertakes adequate actions for timely planning of supplies during the year in order to comply with the legal requirements and that procurement processes are conducted to ensure transparency, competition and value for money. In addition, he should enhance accountability with officers responsible for bid evaluations in order to shortlist EOs with relevant business registered.

Issue 6 –Weaknesses in classification and processing of payments – Medium Priority

Finding **Delay in processing of payments**: Budget Organisation (BO) should pay every valid invoice within 30 calendar days from the date the invoice is received. In nine cases, invoices/liabilities of €9,945 to suppliers were paid after the legal period of 30 days was due. Delays varied from 66 to 84 days.

Wrong classification of expenditures: Expenditures of €2,310 for purchasing two laptops, which according to their nature fall under the category of Capital Investments, were planned, processed and reported in the category of Goods and Services.

Payment from Goods and Services for Ranillug Municipality: Ranillug Municipality filed a request to MLGA for the payment of expenditures for heating "Firewood and coal for schools" with the reasoning of having insufficient budget. Based on this request, MLGA paid €19,200 for "Firewood and coal" from the budget of Goods and Services. Had the criteria been met as foreseen under the Regulation for Subsidies, such purchase should have been made from the category of Subsidies rather than the category of Goods and Services.

Risk Failure to pay for expenditures within the legal deadline and payments from inadequate economic codes and category may result in the budget not being executed according to the plan. As a result, liabilities at the end of the year may increase and set objectives may not be achieved.

Recommendation 6 The Minister should enhance accountability and responsibility with financial officers in order to ensure that invoices are paid within the legal deadline and from the adequate economic category.

4.3.2 Non Procurement Expenditure

Description

We also tested expenditures which do not require the application of procurement procedures such as: Utilities, representation expenditures, expenditures of official travels and other expenditures. Controls have operated well in this area; however, additional actions should be undertaken to eliminate the following shortcomings.

Issue 7 – Exceeding of landline telephony expenditures and delays in closing advance payments – High Priority

Finding

Exceeded telephone expenditures not withheld from the salary: According to a decision by the Permanent Secretary exceeded limits of landline and mobile telephony expenditures set forth by AI no. 04/2008 shall be withheld from salaries. In two months, landline telephony expenditures were exceeded by €765 but the amount was not withheld. According to MLGA, the amount was not withheld on the reasoning that staff had additional engagements, but there was no evidence regarding these engagements.

Failure to close advance payments for official travels in time. According to AI no. 2004/07, all advance payments should be closed 15 days after the return from official travel. In eight cases, advances payments of €6,108 were closed after the legal deadline of 15 days was due. According to MLGA officers, this occurred due to delays in presenting bank reports, since payments were made through bank cards. Bank reports were submitted on the 5th of the following month for the previous month, whilst delays varied from 35 to 95 days.

Insufficient reasoning related to the approval of expenditures for official travels. Expenditures for travels abroad[3] would be covered by the European Commission fund, Cross Border Cooperation (ECCBC). MLGA submitted a list of 10 representatives for participation; however, one of them had cancelled the travel due to another engagement. MLGA asked the EC to include another officer as a participant, but EC did not approve such a change. Despite this, MLGA took the decision to compensate the expenditures €1,327 for this officer from MLGA budget. However, the supporting documents contained no proper reasoning why the officer's need to participate in the training.

[3] Training on cross border cooperation to be held in Austria and Croatia for 10 MLGA representatives

Risk Approval of travel expenditures without a proper reasoning on the need to participate in the training; failure to withhold exceeded amount from salaries, and delays in closing advance payments lead to non-economic use of financial funds.

Recommendation 7 The Minister should ensure that advance payments are closed within the legal deadline and that the employees' exceeded amounts of telephone expenditures are withhold from their salaries. Furthermore, official travels should be approved only when there is proper reasonability and consider more rational spending of financial funds.

4.3.3 Remunerations (Wages and Salaries)

Description

Wages and Salaries are paid through a centralised system (payroll). The key controls operated by MLGA relate to, salary calculation in compliance with employment contracts and the applicable legislation.

MLGA's approved number of employees was 141, whilst the current number was 134. We tested some recruitment procedures, personnel files and reviewed the payroll list and compared the data presented by Treasury, KFMIS and their presentation in AFS.

Issue 8 - Weaknesses in human resources management – High Priority

Finding Test results in the area of personnel identified the following issues:

Promotions not in compliance with the legal framework: In the four following cases, staff promotion was made without conducting internal promotion procedures as set forth in Article 27 of Law on Civil Service and Regulation 21/2012 for Career Promotion of Civil Employees.

- The Rural Development Officer (grade 7) was promoted to Senior Officer for Regional Development (grade 8);
- Municipality Performance Development Officer (grade 7) was promoted to Senior Officer for Municipality Performance Development (grade 8);
- Personnel Files Officer (grade 7) was promoted Senior Personnel Officer (grade 8); and
- Human Rights Officer (grade 6) was transferred to procurement department as Officer for High Value Purchases (grade 7).

Recruitment procedures not adhere to. In two cases, recruitment procedures were not implemented in compliance with Law on Civil Service. The criterion in the vacancy announcement relating to the work[4] experience was not adhered to. In none of the cases, accepted candidates did not prove the work experience as required in the announcement.

Transfer in positions without terminating the probation period. After four months from being hired, the European Integration Officer was transferred to the Budget and Finance Division without terminating the probation period of one year.

Risk Such shortcomings create the possibility for selecting candidates who lack skills and professional experience required for the specific position, resulting in failure to discharge relevant duties and responsibilities.

Recommendation 8 The Minister should ensure that all vacancy announcement criteria are adhered to during staff recruitment in order to ensure candidates with the skills and professional experience required for the specific position are selected. In addition, promotion should be made through promotion procedures. Transfer in some other position should not be made unless officers have terminated the probation period.

[4] In position of Officer for Monitoring Municipalities, three (3) years of work experience was required, while for the position of Officer of European Integration two years of work experience was required.

4.3.4 Subsidies and Transfers

Description

MLGA has developed supervision and monitoring processes of Subsidies and Transfers. However, these processes have not provided complete assurance that subsidies are granted completely according to the objectives set.

Issue 9 – Subsidies granted for reasons other than the ones promoting local governance - Medium Priority

Finding

According to MLGA internal regulation[5], budget allocations from Subsidies and Transfers are made to natural and legal persons for the purpose of upgrading local governance in providing sustainable and transparent services.

In three (3) cases, subsidies were granted for the following purposes:

- Two payments of €1,000 were made for rent and food for two families in Obiliq Municipality. According to MLGA the aim was to help families damaged by the explosion of power plant; whilst

- The payment of €450 was made to one officer for health purposes.

Risk

Granting subsidies for purposes other than the ones promoting local governance increases the risk for the budget for subsidies not being spent cost-effectively and for the intended purpose.

Recommendation 9

The Minister should ensure that subsidies are granted for purposes that promote local governance.

5

4.4 Assets and Liabilities

4.4.1 Capital and Non Capital Assets

Description

According to the KFMIS accounting register, the net value of capital assets over €1000 was €6,785,000, while the value of non-capital assets under €1000 was €635,000.

Capital Investments financed by MLGA in municipalities are initially registered as on-going investments in the MLGA assets registers. At the end of projects, they are transferred under the ownership of municipality and registered in their accounting register.

Our audit on the asset management identified the following issues.

Issue 10 – Weaknesses in asset management - High Priority

Finding	**Asset register overstated:** seven vehicles of €60,507 are still registered in the accounting register. In 2010 they were given for permanent use to some municipalities based on the agreement to support municipalities in delivering their services. These vehicles were transferred to municipalities without the preliminary approval of MoF as required under the Regulation no. 02/2013 on Non-financial Assets Management in Budget Organisations. Thus, MoF, despite the request made from MLGA, did not remove these vehicles from the KFMIS asset register of MLGA. **MLGA officers did not return assets.** Once leaving the job, each BO officer should return assets owned by the BO. Despite the MLGA attempts, 13 officers no longer working in MLGA did not return the assets they have been using such as: laptops and mobile telephones. **Non reconciliation of assets registers with the stocktaking report.** Physical inventory counting for 2014 was done according to the regulation mentioned above. However, there was no reconciliation of data between the assets register and the stocktaking report.

Risk Failure to remove vehicles which are not owned by MLGA from the accounting register may result in the value of assets presented in AFS being overstated. Disposal of assets without complying with legal procedures, non-reconciliation of the accounting register with the stocktaking report and leaving officers failure to return assets increases the risk for assets being misused, lost or alienated.

Recommendation 10 The Minister should ensure that adequate controls are established to enable asset management in accordance to legal requirements. Further on, should initiate a procedure to remove the vehicles that are not any longer a property of the ministry from the KFMIS.

4.4.2 Handling of Debts

Description

The statement of outstanding liabilities at the end of 2014 was €66,392. These liabilities are carried forward to be paid in 2015. Compared to the previous year, the liabilities not paid have considerably decreased. Invoices for liabilities not paid date from December 2014.

Issue 11 – Outstanding liabilities - Medium Priority

Finding €52,000 of the liabilities relate to Capital Investments, whilst the budget spent in this category was just 75%. Outstanding liabilities at the end of the year were mainly due to delays in commitments of funds and issuance of purchase orders.

Risk Failure to timely commit funds and issuing purchase orders after the invoice is received increase the outstanding liabilities at the end of the year which leads to budget burdens in the following years.

Recommendation 11 The Minister should ensure that commitment of funds and issuance of purchase orders are done before entering into obligations in order to reduce the value of outstanding liabilities down to a minimum level.

4.5 Internal Audit System

Description

The Internal Audit Unit (IAU) for 2014 planned to carry out five regular audits and two ad hoc audits. By the end of the year, IAU finalised three audit reports.

The quality of finalised reports was good. They provided the Management with information and assessments on the effectiveness of established controls and their functioning in relevant areas. However, the Management has not prepared an action plan for implementation of recommendations. As a result, there were setbacks in the implementation of IAU recommendations.

The Audit Committee held regular quarterly meetings where IAU reports were assessed and handled.

Issue 12 - Annual work plan - High Priority

Finding	The IAU was unable to fully meet the annual work plan. Only three[6] out of five planned audits were finalised. One audit related to personnel management was stopped on Management request and was carried on later with the reasoning that staff was on holidays. When it comes to the area of management of Capital Investments, IAU did not carry out any audits in the last two years, with the reasoning that expenditures in this category were executed by the end of the year.
Risk	IA has not provided assurance on the effectiveness of Internal Controls during 2014 in the area of Capital Investments and personnel management. Given that the largest part of budget is executed in the category of Capital Investments, not identified and not addressed weaknesses may result in financial loss for MLGA.
Recommendation 12	The Minister should ensure that IA activity focuses on the development and implementation of a risk based audit strategy in the future. This should provide the Management with annual assurance over the effectiveness (or otherwise) of internal controls systems for all significant expenditure flows.

[6] Audit in the area of procurement management in MLGA, management of vehicles and IT, and budget, accounting and payments management

Issue 13 – Action plan for addressing the IA recommendations not prepared– High Priority

Finding	IAU finalised three reports during 2014 resulting in recommendations the implementation of which would improve internal controls of MLGA. However, the Management did not prepare an action plan for implementing IAU recommendations. As a result, there setbacks in their implementation.
Risk	Failure to prepare the plan for implementing IAU recommendations which would determine the timetable and accountable staff for their implementation, leads to failure to improve internal controls and increases the risk that same shortcomings are repeated.
Recommendation 13	The Minister should ensure that the benefit form internal audit work is taken into consideration by preparing an action plan for the implementation of IAU recommendations and undertake concrete actions for their implementation.

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

(extract from ISSAI 200)

Form of opinion

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

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

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

Modifications to the opinion in the auditor's report

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

Determining the type of modification to the auditor's opinion

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

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

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

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

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

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 1705[19] provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

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

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

158. An Emphasis of Matter paragraph should:

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

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

Annex II: Prior Year Recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
3. Addressing Prior Year Audit Recommendations	The Minister should ensure that measures set forth in the action plan on the areas with emphasised deficiencies are constantly reviewed and monitored in order to ensure that they are fully addressed by the accountable staff members.		Partly	
4.1 Budget Planning and Execution	The Minister should conduct a systematic assessment of the reasons behind the low level of overall budget execution, and eliminate weaknesses either at the budget planning stage or at implementation stage.			No
	The Minister should ensure a systematic monitoring of budget performance on a monthly basis in order to improve it, and should also identify and address barriers to plan budget execution levels.		Partly	
4.2 Expenditures 4.2.1 Procurement	The Minister should ensure that needs for goods and services and capital investments are identified in time and the approximate value of expenditures is determined in order to reduce risks/departure from legal rules. Moreover, Minister should increase the level of cooperation with respective municipalities at the planning stage in order to conduct identification of needs in time and have a good planning of procurement expenditures.	Yes		
	The Minister should ensure that controls are enhanced before signing the contract in order to ensure that funds are committed from the adequate category and that, while getting processed, payments are registered according to the codes in the accounting plan.	Yes		

	The Minister should ensure mechanisms of cooperation are strengthened and that ongoing oversight during the capital projects funded by MLGA is enhanced in order to increase responsibility and accountability at a higher level.	Yes		
	The Minister should ensure that MoU is fully adhered to in order to eliminate repetition of same shortcomings in the future. In case there is a need for the modification of MoU, all eventual financial implications for all parties involved in the co-financing should be taken into account.	Yes		
	The Minister should ensure that, prior to the initiation of procurement procedures; appropriate analyses are made relating to real needs of MLGA in order to achieve the set objectives at a reasonable cost.			No
4.3 Assets and Liabilities	The Minister should ensure that assets are managed according to legal requirements in order to prevent them from loss or misuse. To this end, the inventory and valuation of assets should be carried out each year.		Partly	
4.4 Handling of debts	The Minster should analyse the reasons behind the increase of liabilities and ensure that capital projects activities are planned in time in order that liabilities will not burden the upcoming year's budget. In addition it should be ensured that there is sufficient budget prior to initiating the supply with goods and services.		Partly	
5. Internal audit	The Minister should work with IAU Director to ensure that sufficient assurance is provided by IAU regarding the functioning of controls in the areas where risks are assessed to be high. In the upcoming years, accomplishment of IAU planned activities are monitored by Audit Committee every two months and proactive actions should be taken in order that deviations from the plan are addressed in due time.		Partly	